House of Commons
International Development Committee

The Future of UK Development Co-operation: Phase 1: Development Finance

Eighth Report of Session 2013–14

Volume I: Report, together with formal minutes, oral and written evidence

Additional written evidence is contained in Volume II, available on the Committee website at www.parliament.uk/indcom

Ordered by the House of Commons
to be printed 5 February 2014

HC 334
Published on 12 February 2014
by authority of the House of Commons
London: The Stationery Office Limited
£22.00
The International Development Committee

The International Development Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Office of the Secretary of State for International Development

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The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and some or all written evidence are available in a printed volume.

Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee are Dr David Harrison (Clerk), Chloe Challender (Senior Adviser), Louise Whiteley (Committee Specialist), Rob Page (Committee Specialist), Polly Meeks (Committee Specialist), Anita Fuki (Senior Committee Assistant), Paul Hampson (Committee Support Assistant) and Hannah Pearce (Media Officer).

Contacts

All correspondence should be addressed to the Clerk of the International Development Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 1223; the Committee's email address is indcom@parliament.uk
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Summary

There has been huge progress in developing countries. The percentage of the world’s population living in extreme poverty since 1990 has halved, and the prospect of ending extreme poverty by 2030 is within our reach. The aim of developing countries taking on the responsibility of funding their own services is increasingly being realized. However, aid is still of critical importance, especially for reaching the very poorest people in Low Income Countries (LICs) and the World Bank has noted that aid is expected to remain a critical input to achieve the new development agenda. The UK should retain its focus on using aid primarily to help poor people in poor countries. Meeting the needs of the poorest in Low Income Countries, supporting the transition in Middle Income Countries (MICs), and financing global public goods all make the case for significant development finance. We fully support the international commitment to the 0.7% aid target and believe that it should be maintained.

Development aid in the form of grants is very limited and precious and it is getting increasingly difficult to make the case for giving aid in the form of grants to MICs. We believe that DFID should also develop the capacity to distribute aid in the form of concessional and non-concessional loans either “in house” or by establishing a UK development bank. We recognise that it is will take time to build the capacity to manage loan finance but the expectation, once the capacity has been established, should be that grants to MICs should only be used where no other form of finance is possible. There may also be circumstances where loan finance would be appropriate in LICs, for example to finance infrastructure, such as power generation, which will generate a return on investment, but care should be taken not to re-burden least developed countries with unmanageable debt. We believe that grants should continue to be used for financing access to basic minimum needs in LICs like health, education, sanitation and water and where speed is of the essence, for example for emergency relief; for failed states and major conflict areas; and for global public goods which cannot be funded in other ways.

Supporting the private sector can have significant benefits in terms of boosting economic growth, creating jobs in developing countries and helping to deliver projects with other social benefits. We think that there is considerable scope for support to the private sector, but it will be necessary to avoid the disadvantages such as giving one private company a competitive advantage over others. As private sector projects are expected to make a return, we recommend that when DFID is dealing with the private sector, the presumption should be that finance will be provided as returnable capital.

Establishing a UK development bank could give the DFID bilateral programme a way of providing a wider range of finance instruments, including concessional loans and so increase the impact of its aid spending. We recognise that it would be a major undertaking, but believe that DFID must plan for the long term.

One option open to DFID would be to channel more of its finance through multilaterals, and to make use of their wide range of specialist skills and expertise, rather than attempt to replicate all of these in its bilateral programmes. In order to determine the appropriate balance of bilateral and multilateral spending, DFID must be able to compare the relative
outcomes and value for money of these different channels. DFID must also maintain sufficient influence within multilaterals in order to monitor and influence their spending priorities.

We recommend that DFID establish a financial instrument team that can prepare a development finance strategy; coordinate the various finance initiatives that are currently being piloted by DFID; draw together the different bilateral and multilateral approaches; design new instruments and build up the necessary skills for future innovation and development. Without this effort, DFID may not be in a position to establish a development bank if and when it were deemed advantageous to do so.

We welcome the Secretary of State’s initiative of conducting a review into how DFID should respond to the changes in the development landscape. We recommend that this should include the publication of a development finance strategy for the coming decade, setting out DFID’s analysis of the issues to which it must respond, the pros and cons of different options, its preferred approach and the reasons for those choices. This should take the form of a Development Finance White paper, to be published during 2014.
1 Introduction

1. There are a number of changes affecting developing countries and development finance, such as the changing geography of poverty, an increasing focus on global public goods and the emergence of new sources and types of finance. The future strategy of the Department for International Development (DFID) will need to set out how it will respond to these changes, and we therefore decided to undertake an inquiry into the Future of UK Development Cooperation. In October 2012 we published a call for evidence, inviting comments on the main global factors affecting poverty; the future role of development aid; whether DFID should offer concessional loans; the impact of non-aid policies on development; the UK’s ability to influence the future global development agenda; and what the future of UK development cooperation should look like. We received a number of useful submissions which helped us to plan the phases of our overall inquiry, and decided to begin with an inquiry into aspects of development finance.

2. We published a further call for evidence in May 2013, seeking views on whether the 0.7% aid target will be appropriate in the long term; whether DFID has the right mix of financial instruments; whether the UK should establish a new, independent development finance institution; whether DFID has the right balance between bilateral and multilateral aid; what lessons can be learned from other national donors; and how DFID should monitor and influence expenditure by multilateral institutions, especially in countries and regions where DFID does not have a bilateral programme.

3. We received 20 written submissions from a range of organisations and individuals, and held four oral evidence sessions between June and October 2013. We also held informal briefings with the Overseas Development Institute (ODI) and with experts from Chatham House, and held informal meetings with the President of the World Bank and with the Japan International Cooperation Agency (JICA). This inquiry was also informed by our visit in September to Washington and Brazil, where we held meetings with the World Bank, the Inter American Development Bank, the Brazilian government and other development organisations. We are very grateful to all those who provided oral and written evidence, and to those who contributed to our informal meetings and to our overseas visit. We would like to thank our specialist adviser, Dr Dirk Willem te Velde of ODI.

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1 The term financial instrument is used to refer to the different ways of providing finance, such as grants, loans, equity and other forms of finance.
2 The changing context of development

4. Substantial progress has been made towards achieving some of the Millennium Development Goals (MDGs), most notably a halving of the proportion of people in the world who are living in extreme poverty between 1990 and 2010. But countries are falling short on other goals such as environmental sustainability, and there has been slow progress in some regions and countries, where inequality and extreme poverty persists. Projections indicate that in 2015 almost one billion people will be living on an income of less than $1.25 per day. DFID is respected as an experienced and effective provider of development assistance and is currently conducting a review of how it should respond to the changes in the development landscape. In this Chapter we review some of the changes which it may need to address in order to remain effective in the future. There have also been major changes in the financing of development assistance which we discuss in Chapter 3.

The changing geography of poverty

5. The changing geography of poverty is an important factor affecting the future role and provision of aid. Currently, around half of the world’s poor live in India and China, a quarter in other middle income countries (MICs), primarily populous lower MICs such as Pakistan, Nigeria and Indonesia, and a quarter in the remaining 35 low-income countries (LICs). Some academics believe that this will be a transitory phenomenon, and that by 2025, poverty will increasingly be concentrated in fragile and conflict-affected states. Others argue that a significant amount of world poverty could easily remain in stable MICs, or that it could become more concentrated in fragile MICs such as Pakistan and Nigeria. Development Initiatives points out that the depth of poverty is also significant; that many people in Africa live a long way below the poverty line and so will need greater effort and resources to be helped out of poverty. DFID’s bilateral country programme is primarily targeted at LICs, but the number of non-fragile LICs is reducing and some experts believe that these countries have a limited absorptive capacity for aid. The UK has promised more aid to fragile and conflict-affected states, with the proportion of its Overseas Development Assistance (ODA or ‘aid’) going to these countries rising from 22% in 2010–11 to 30% by 2014–15.

3 Q 238
5 ODI, Horizon 2025: creative destruction in the aid industry, July 2012, Homi Kharas and Andrew Rogerson
7 Development Initiatives, Investments to end poverty, September 2013, p20
8 DFID provides both bilateral assistance (aid provided to specified developing countries) and multilateral assistance (aid provided via contributions to international organisations)
9 As defined by the World Bank’s annual classification of the world’s economies, based on estimates of gross national income (GNI) per capita for the previous year
10 Ev w30
6. There is debate about whether it is appropriate to use ODA to help eliminate extreme poverty in MICs, when these countries have the resources to do more for themselves. The previous UK Government took the decision to close DFID’s bilateral aid programme in China. In recent months, DFID has decided to end its bilateral programme in South Africa, on the basis that it has reached an income level where it is no longer appropriate to provide grant based ODA. DFID’s bilateral programme in India is also being scaled down significantly; financial aid will end in 2015, with a shift towards technical assistance. The World Bank categorises economies according to gross national income (GNI) per capita, and currently sets the following levels: low income, $1,035 or less; lower middle income, $1,036 to $4,085; upper middle income, $4,086 to $12,615; and high income, $12,616 or more. There are considerable differences in the average annual income levels of different MICs, ranging from for example $1,530 in India and $2,470 in the Philippines to $5,680 in China and $11,630 in Brazil. The comparable figure for the UK is $38,500. There are also considerable differences within countries; for example, although India is defined as a MIC, DFID estimates that around 300 million people in India still live on less than 80 pence a day. It is clear, nevertheless, that a MIC like India has a much greater capacity than a LIC like Malawi, to fund development and eliminate poverty by taxing its citizens on higher incomes and using the revenue to lift poorer citizens out of poverty, which, of course, India does as we noted in our 2011 report “The Future of DFID’s Programme in India.

7. As table one indicates, there have been significant fluctuations in the percentage of bilateral aid spent in LICs. Spending peaked at 85% in 2006–07, but fell to 65% in 2011–12. DFID explained that The Table shows a 15 point reduction in the percentage of country-specific non-humanitarian bilateral spending going to low income countries in 2011–12 compared to the previous year. DFID said this reduction was due to two main factors: countries graduating from low income to lower middle income status on the DAC list of eligible countries; and changes to the countries to which DFID provided bilateral country specific support. DFID informed us that

In 2011–12, three countries Nigeria, Pakistan and Ghana graduated to lower middle income status. DFID’s total non-humanitarian bilateral assistance in these countries totalled £394 million in 2011–12, the equivalent of 15.0% of DFID’s total country specific non-humanitarian bilateral assistance. The reclassification of these countries as lower middle income was therefore the main driver behind the reduction in DFID aid to low income countries.”

Table 1. Percentage of country-specific DFID bilateral spending that went to low income countries

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12 http://data.worldbank.org/about/country-classifications
We were surprised to see a huge fall in the percentage of UK bilateral ODA spending on Low Income Countries. We note DFID’s explanation that the main reason is the graduation of countries to middle income status. Nevertheless, we recommend that DFID maintain spending on Low Income Countries as its priority. We further recommend that DFID review its programmes in all MICs to examine the scope for reallocating bilateral aid from MICs to LICs and to set a timetable for doing so.

8. Several witnesses argued that aid was still critical for helping to reduce extreme poverty in MICs. Owen Barder, Senior Fellow at the Center for Global Development, said that “You simply could not redistribute all the money from the wealthiest people in India and solve the poverty problem there.” Jonathan Glennie, Research Fellow at ODI, argued that “Middle Income Countries are where the vast majority of the poor live. ... They are immensely important for security, climate and other sustainability issues.” Oxfam GB agreed, saying that:

it is crucial that donors continue to provide ODA to MICs to tackle poverty and inequality, achieve the MDGs and reach the poorest people where their basic needs are unmet by the government or market. This does not absolve MIC governments of their responsibility to pursue redistributive policies to tackle poverty and inequality, but while extreme need exists in MICs, DFID should provide aid whilst working more with national governments to tackle poverty and inequality.

9. Some witnesses suggested that the categorisation of LICs and MICs was no longer the best way of determining which countries should receive aid. Andrew Rogerson, Senior Research Associate at ODI, said “I think increasingly the issue of at what point you cross a statistical line called "middle income" will become irrelevant. The basic conditions—"Is the country well governed? Is it capable of making use of external resources?"—are the real drivers.” There are also suggestions that an overly narrow focus on extreme poverty is unhelpful. The World Bank now has a strategy which focuses both on fighting extreme poverty (defined as an average daily consumption of $1.25 or less) and on boosting shared prosperity, with the aim of helping all vulnerable people lift themselves well above the poverty line.

10. Professor Stefan Dercon, DFID’s Chief Economist, explained that many MICs, including India, had good growth and poverty reduction trajectories, and that DFID was aiming to focus its bilateral programme on countries with high levels of poverty, but less positive growth prospects, where it could have a comparative advantage. DFID aimed to avoid spreading itself too thinly, and its bilateral programmes would inevitably not reach every country in need, but it was able to have a wider geographical reach through its

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13 Q 46
14 Q 11
15 Ev w5
16 Q 43
17 Q 2
18 This is calculated on the basis of purchasing power parity, and therefore means people who are living on the equivalent of what $1.25 (or $2) would buy in the USA.
19 World Bank Group, Ending extreme poverty and promoting shared prosperity, 19 April 2013
multilateral programme. The Rt Hon Justine Greening MP, Secretary of State for International Development, explained that for countries in transition out of bilateral grant aid programmes, DFID aimed to continue to provide support in the form of advice, help with economic development and private sector investment, as well as continued support for multilateral programmes such as those to tackle AIDS, TB and malaria.

Global public goods and the role of aid

11. The Prime Minister, the Rt Hon David Cameron MP, was one of three co-Chairs of the High-level Panel, which was tasked with making recommendations on a post-2015 development agenda. In its report, published in May 2013, the panel proposed that the post-2015 agenda should be driven by the following five objectives: ending extreme poverty; halting the rapid pace of climate change; transforming economies for jobs and inclusive growth; building peace, good governance and increasing accountability and transparency; and forging new global partnerships to underpin the new agenda. These objectives are set in the context of a number of significant global changes. DFID told us that it undertakes regular horizon scans to explore these changes, and highlighted the following five main trends: rapid population growth in developing countries; increased urbanisation, leading to a risk of poorly-planned and under-serviced cities; the increasing impact of climate change; resource scarcity, such as potentially critical scarcity of water, energy and land in some areas; and increasing access to technology, and the potential to use technology to strengthen the impact of development cooperation.

12. The proposed post-2015 objectives address a range of issues, such as economic growth and environmental sustainability, as well as poverty reduction. In previous Reports we have recognised the importance of these wider goals in helping poor countries to grow. The International Development Act 2002 requires UK development assistance to be focused explicitly on the reduction of poverty, whereas the Organisation for Economic Co-operation and Development (OECD) definition of ODA refers more broadly to the promotion of economic development and welfare of developing countries. The provision of aid can have benefits for donor countries, as well as recipients. A recent World Bank report noted that “trade, finance and other links among emerging market and developing economies are growing” and that “this shift offers opportunities for new, mutually beneficial partnerships”. In her oral evidence to us, the Secretary of State explicitly acknowledged some of the wider potential benefits to the UK of providing aid, in terms of building beneficial trade with emerging economies and reducing terrorism.
13. There is continuing debate about the extent to which aid should encompass international cooperation on global public goods. The World Bank identifies five areas of global public goods for its engagement: environmental issues; communicable diseases; international trade; international financial architecture; and global knowledge for development. One of the key areas of debate is the management of climate change. A recent report from the Intergovernmental Panel on Climate Change noted that “It is extremely likely that human influence has been the dominant cause of the observed warming [of the atmosphere and the ocean] since the mid-20th century” and that “Continued emissions of greenhouse gases will cause further warming and changes in all components of the climate system.” The UK has a cross-Government approach to tackling climate change, with DFID taking the lead on ensuring that the impact on the world’s poor is considered throughout. The UK’s climate finance contribution helps developing countries incorporate climate change into their development strategies and to support climate-compatible development. It is expected that the Green Climate Fund, the capitalisation of which should take place in 2014, will have a significant impact on development financing and provide new opportunities for the Government.

14. There is also debate about the existing OECD Development Assistance Committee (DAC) definitions, which activities can be categorised as ODA and how the aid element of different forms of development financing should be calculated. Some of the issues under discussion include military and peacekeeping activities, climate finance and private sector investment. The DAC Expert Reference Group on External Financing is currently considering whether and how to revise the definition of ODA. The Secretary of State agreed that there was a need to review DAC’s ODA definition to ensure it remained effective, but that “it would not be sensible to start broadening it out as a concept so much that you end up losing sight of what you were ultimately trying to achieve.” Professor Dercon said that spending on climate adaptation in developing countries was generally recognised as contributing to poverty reduction, but that it would be helpful to think carefully about the proper accounting of this type of ODA contributions.

28 A global public good is a public good, such as the eradication of a disease, which is available throughout the world, rather than benefiting only a specific region.


31 Ev 88

32 The Green Climate Fund is a new multilateral fund which was agreed by countries at the 2010 United Nations Framework Convention on Climate Change conference. Its purpose is to make a significant contribution to the global efforts to limit warming to two degrees Celsius by providing support to developing countries to help limit or reduce their greenhouse gas emissions, and to adapt to the unavoidable impacts of climate change.


34 Q 231

35 Q 233
The 0.7% target

15. In 2013, the UK Government aims to achieve the agreed international target of contributing 0.7% of its gross national income (GNI) in aid. In 2012, the UK’s total aid expenditure reached £8.7 billion, or 0.56% of GNI, which represents a doubling of the aid to GNI ratio since 1997 when it was 0.26% of national income. Only five other DAC countries have reached the 0.7% target in any one year: Norway, Sweden, Netherlands, Denmark and Luxembourg. Although the USA gives the largest amount of aid, it was ranked eighteenth in 2012 in terms of ODA as a percentage of GNI.36

16. Witnesses generally agreed that it was helpful to have the 0.7% target. Jonathan Glennie said that “If it incentivises countries/people/Governments to do the right thing, then it is important”.37 Richard Manning, the former DAC Chair, suggested that “there is some value in an international norm that incentivises countries to move in a particular direction, particularly for a category of spending that is not self-evidently in their very short-term interests”.38 There was less certainty about whether the 0.7% target would deliver sufficient resources. The written submission from ODI researchers suggested that:

There appear to be two broad scenarios. Either aid gradually declines as poverty is reduced globally and countries rely more on non-concessional flows. Or aid continues to be of importance, as objectives multiply and the unique character of public finance at a global level is considered important. In the former scenario, the 0.7% target would seem too high; in the latter it may not be sufficient.39

Holger Rothenbusch, Managing Director, CDC,40 suggested that factors other than the amounts of capital were likely to be of increasing importance, saying that “... it is not only capital that is required. It is also supportive technical assistance; it is the effectiveness of the intervention that is being pursued by the different entities rather than the amount of dollars, pounds or Euros that you can ultimately put on your scorecard.”41 Peter Young, Director, Adam Smith International, agreed that provision of finance was not sufficient on its own without resolving other issues, and gave the example of Nigeria, where the majority of the population do not have titles to their land and property and so cannot provide collateral for bank loans.42

17. DFID has noted that the “EU is unlikely to meet 0.7% GNI target by 2015, but we will push for continued EU commitment to 0.7% on an extended (ie 2016–2017) timetable”.43 The Secretary of State expressed continued support for the international commitment to 0.7%. She said that other countries might take a slightly different view of the benefits of

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36 DFID Statistics 2013, p72. ODA statistics are provided for calendar years.
37 Q 18
38 Q 2
39 Ev 114
40 CDC is the UK’s development finance institution which is wholly owned by the Government but operates independently
41 Q187
42 Q 50
43 DFID, Global Partnerships Department, Operational Plan 2011–2015, June 2012
investing in development, but that the UK wanted to see them live up to the commitment, and that it was in the UK’s national interest to continue to meet the target:

Ultimately, I believe that spending this 0.7%, if done effectively, is absolutely in our national interest. ... It is in our interest to help countries stay stable, so that we can stay safe and have a better chance of reducing terrorism. It is absolutely in our interest as a country to be working in that next wave of emerging countries.  

18. There has been huge progress in developing countries. The number of people living in extreme poverty since 1990 has halved, and the prospect of ending extreme poverty by 2030 is within reach. Aid is still of critical importance, especially for reaching the very poorest people in Low Income Countries and we believe that they should remain the priority for UK aid. Aid programmes can help to build mutually beneficial trade and economic cooperation relationships with emerging economies and we believe that a stronger emphasis on economic development can be fully consistent with poverty reduction. As a first step, we recommend that DFID work with the OECD DAC to review, update and clarify the ODA definitions.

19. Members of the Committee, during visits to developing countries, have observed repeatedly the enormous inequalities in income, health, education and life prospects for the people in developing countries compared to those in richer countries like the UK and, frequently also, the gross inequality between richer and poorer people within developing countries. The High Level Panel drew attention to the continuing challenge of addressing inequality and rightly emphasises the maxim “Leave No One Behind”. We recommend that DFID should set out in its response to this report what steps it intends to take to assist in the reduction of inequality globally and within the developing countries in which it has bilateral programmes.

20. We recommend that, in general, Middle Income Countries should graduate from aid, but in a controlled manner which takes account of needs and resources. During the transition period, we recommend that aid programmes make more use of technical assistance, support to NGOs, and loans, as discussed later in this Report. Meeting the needs of the poorest in Low Income Countries should remain our priority, but supporting transition in Middle Income Countries, and financing global public goods all make the case for significant development finance. We plan to hold a separate inquiry in the future into climate finance. We fully support the international commitment to the 0.7% aid target and believe that it should be maintained.

21. In this connection, we welcome the Secretary of State’s initiative of conducting a review into how DFID should respond to the changes in the development landscape. We recommend that this should include the publication of a development finance strategy for the coming decade, setting out DFID’s analysis of the issues to which it must respond, the pros and cons of different options, its preferred approach and the reasons for those choices. It should include an assessment of the following issues:

- the function of aid, should it remain focused on poverty reduction and economic growth, but in the longer term should it also include international
cooperation on global public goods if so, what are the implications of this for both future funding requirements and cooperation with other Government Departments?

- Climate finance, which requires much more serious analysis, including the extent to which aid is used to fund climate related projects and which countries should be eligible for aid to fund such projects.

- The OECD definition of ODA; how DFID will work with the OECD review to ensure that the focus remains on addressing poverty? We believe that DFID should make a statement about its proposals for change in the definition before the Summer Recess 2014 to give Parliament and civil society the opportunity to comment on the Government’s objectives before the OECD finalises any changes at the meeting of OECD Ministers in December.

- Whom is aid for: just for low income countries, or for people in poverty wherever they live? Whether the existing definitions of low, middle and high income countries are still useful or whether there are better ways of defining priority countries and identifying financing gaps? Should aid be targeted at extreme poverty, or at other levels of poverty as well, or at countries with large financing gaps and weak prospects for economic growth? How can aid help to reduce inequality when average incomes are rising but poverty levels are not reducing?

- The thresholds for defining Middle Income Countries needs to be reviewed and updated. We urge DFID to encourage the World Bank to examine them.

- DFID’s strategy for aid to middle income countries: how will DFID identify and respond to the continuing development needs of these countries? What criteria will it use to withdraw aid from countries as they transition, and how will it decide to start different types of relationships based on different instruments?

- The contribution of DFID and its financial mechanisms towards addressing inequality, equalising opportunities and ensuring that no one is left behind.
3 Development finance challenges

22. The global policy context for development finance is changing, and the UK is actively engaged in a number of different debates on the future of development finance.\textsuperscript{45} The aim of developing countries taking on the responsibility of funding their own services is increasingly being realised. For example countries such as Vietnam have relied less on external aid and more on other capital flows as they have grown and developed.\textsuperscript{46} A recent World Bank report on development finance reviewed some of these key changes, and concluded that the ability to finance a post-2015 development framework depended on global development cooperation, good policies, and “credible institutions to increase the impact of scarce resources and to leverage additional resources from both domestic and foreign, public and private sources”.\textsuperscript{47} In this Chapter, we consider changes in the sources of development finance and the emergence of new financial instruments, in order to examine how DFID might best contribute to this global development cooperation, and how it can remain relevant and effective in responding to the changing needs of developing countries.

Changes in development finance

23. The nature of capital flows to developing countries and the role of development assistance are changing rapidly. As recently as the year 2000, development assistance was overwhelmingly provided by traditional bilateral and multilateral donors, but today it is being supplemented by other forms of development assistance. These other sources include non-DAC donors (such as China), climate finance funds, social impact investors,\textsuperscript{48} philanthropists and global funds, as well as other less concessional flows.\textsuperscript{49} Other capital flows such as foreign direct investment, portfolio bond and equity flows and remittances have increased,\textsuperscript{50} and developing countries are increasingly able to access other non-concessional sources of finance. For example, Richard Manning referred to the issuing of bonds by African countries:

\textsuperscript{45} These include the 2nd UN Review Conference on financing for Development expected in 2015 and the work on Financing the Rio+20 plans in June 2012 which will be taken forward by the Intergovernmental Committee of Experts on Sustainable Development Financing recently agreed by the UN General Assembly. The 2014 UN General Assembly will begin the process to bring together the discussions on post-2015 development goals and the ways to achieve these, including through financing. In addition, the Global Partnership for Effective Development Cooperation, which emerged from the 4th High Level Forum on aid effectiveness took place in Busan South Korea in 2011, will organise a high level ministerial conference in April 2014.

\textsuperscript{46} Towards a new generation of Aid for Trade, Dirk Willem te Velde, October 2013, International Trade

\textsuperscript{47} Financing for development post-2015, p ix

\textsuperscript{48} Social impact investments are financial investments made with the objective of generating a measurable social and environmental impact. Some may also generate a financial return.

\textsuperscript{49} ODI, The Age of Choice, Greenhill, Prizzon and Rogerson, March 2013

\textsuperscript{50} Note on capital flows to developing countries, Dirk Willem te Velde, Annex 1
Ghana, a country which was desperately marginalised in the 1980s, famously launched a Eurobond in 2008. Other poor African countries, many of them recipients of debt cancellation and HIPC, have been doing the same in the recent past, so we are definitely in a different world.\textsuperscript{51}

Figures a, b and c show financial flows to developing countries

\textbf{Figure a, ‘International Capital Flows to Developing Countries, 2012 (in US$ billions and as a % of total flows)\textsuperscript{52}:}

![Financial flows diagram]

\textit{Note: FDI inflows are net of disinvestments by non-residents. Debt Inflows are debt disbursements net of repayments. Official flows include bilateral and multilateral lending and are not equivalent to ODA. Data on official capital inflows are “debt enhancing official assistance”, and thus not the same as ODA, which is concessional in character with a grant element.}

\textsuperscript{51} Q 2. HIPC refers to the 39 Heavily Indebted Poor Countries which are eligible for special assistance from the International Monetary Fund and the World Bank

\textsuperscript{52} World Bank \textit{Financing for Development Post-2015}, 2013
International resource flows to developing countries have grown rapidly

Note: Data for some flows does not cover the whole period – see Methodology. Excludes flows with no historic data, so headline figures are lower than the total US$2.1 trillion inflows in 2011.

Source: Based on data from a wide range of sources – see Methodology.

Figure c: Trends in development assistance flows, for 2000 and 2009 (US billion)


53 Development Initiatives Investments to end poverty by 2030, 2013
Figure d shows the declining importance of ODA to middle income countries.

Figure d, Financial flows to middle income countries, % of national income

Source: World Development Indicators

24. The range and impact of these new sources of finance have been evaluated in a number of research papers. An ODI analysis found that recipient countries welcomed the increased choice, ownership, alignment and speed of new finance sources. But it also suggested that the increased choice of finance options open to recipients may make it more difficult for traditional donors to influence policy and that donors may need to be clearer about their own ‘niche’ in relation to competition from other finance providers. Although aid is an increasingly small share of total capital flows into developing countries, it can still be substantial for specific countries. A recent analysis by Development Initiatives concluded that ODA remains the main international source for countries with government spending of less than $500 per person per year, and the World Bank notes that “ODA is expected to remain a critical input to achieve the new development agenda”. The Development Initiatives report comments that “Aid continues to be of great significance to some of the poorest people and countries … In these countries, ODA continues to fund investments to get girls into school; increase access to treatment for HIV/AIDS, malaria and TB; provide water and sanitation; and support social protection schemes. Overall, ODA remains the largest international resource flow for 43 countries.

54 Accessed 17 December 2013, FDI = Foreign direct investment, net inflows (% of GDP), ODA = Net ODA received (% of GNI), Remittances = Personal remittances, received (% of GDP), Tax = Tax revenue (% of GDP)
55 Eg Development Initiatives, Investments to end poverty; ODI, Inclusive and sustainable development, September 2012; World Bank Group, Financing for Development post-2015
56 ODI, The Age of Choice
57 On a purchasing power parity basis
58 Development Initiatives, Investments to End Poverty
59 World Bank Group, Financing for Development post-2015, p x
60 Development Initiatives, Investments to End Poverty, p64
25. Witnesses agreed that, despite the availability of new sources and types of finance, aid could still play a critical role in the coming years. Professor Stephany Griffith-Jones, of Columbia University, told us that “aid and concessional flows still have a very important role to play, even though the landscape is changing very rapidly” and Jonathan Glennie that “a lot of new money is much faster money ... but may not have that focus on institution building or on social and environmental impact that has been such an important part of the last 10 years of aid effectiveness”. Matthew Martin, Director, Development Finance International, agreed, saying that “sometimes people exaggerate the scale of the change ... of course there is foreign investment, remittances and all the other things out there. If you actually look at the key countries DFID aid is intended to help, the key source of net financing ... is concessional flows”. Figure e shows the importance of ODA for the lowest income countries.

![Figure e: Financial flows to low income countries, % of national income](source: World Development Indicators)

**DFID’s current approach**

26. Around 87% of UK ODA is spent by DFID, with the other main UK providers of ODA being the Foreign and Commonwealth Office and the Department of Energy and Climate Change which each account for a further 3%. In 2012–13 DFID spent just under half of its development budget through core contributions to multilateral organisations, around a quarter as bilateral spend through multilateral organisations, and the remainder through UK bilateral programmes. DFID currently has bilateral programmes in 28 countries in

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61 Q 27
62 Q 15
63 Q 27
64 Accessed 17 December 2013, FDI = Foreign direct investment, net inflows (% of GDP), ODA = Net ODA received (% of GNI), Remittances = Personal remittances, received (% of GDP), Tax = Tax revenue (% of GDP), tax data for 2000 taken from 2002.
65 DFID Statistics on International Development 2013, p23
66 DFID Annual Report 2012–13, p112
Africa, Asia and the Middle East, where it provides aid via grants (general budget support, sector budget support and funding of specific projects and programmes) and technical assistance.67

27. DFID’s Global Partnerships Department is responsible for broader international relationships and is for example developing joint programmes with emerging powers, particularly China, Brazil, India, South Africa and the Gulf.68 DFID does not currently provide bilateral concessional loans, but the multilaterals to which it contributes use both loans and grants, as well as a range of other instruments such as equities and guarantees. DFID is also increasingly working with the private sector through bodies such as CDC and the Private Sector Infrastructure Group (PIDG) and a range of challenge funds such as the Africa Enterprise Challenge Fund and Impact Investment.

Approach of other national donors

28. In 2012, the UK was the second largest OECD DAC donor in volume terms, spending £8.7 billion on ODA. The largest provider was the USA, and other major donors were Germany, France and Japan.69 In order to learn about the approach of other national donors, the Committee has held informal discussions with representatives from the Japan International Cooperation Agency (JICA) and Agence Francaise de Developpement (AFD, the French development bank), and received oral evidence from the German Federal Ministry for Economic Cooperation and Development and Development and KfW Entwicklungsbank (the German development bank).

Japan

29. Japan provides the majority of its ODA as loans, but it also provides grants and technical assistance. In 2012, Japan’s net ODA amounted to £6.6 billion (0.17% GNI).70 In response to some of the changes in the development landscape, Japan has been moving towards a greater integration of its development assistance schemes,71 and JICA was formed in its current structure in October 2008. International development policy is determined by the Japan Foreign Ministry, and also by the Finance and the Environment Ministries. JICA is an independent Government agency which supports the policy formation process and implements projects and programmes.

30. JICA has typically provided funding to the public sector, but has recently also restarted private sector financing. It provides loans and private sector investment finance through a Finance and Investment Account, which is separate from the general account used for aid. JICA can offer developing countries repayment periods of 30–40 years which would not be available on the market, and also offer repayment terms which help maintain debt sustainability. JICA’s capital is mainly funded by the Government of Japan which may, when it finds necessary, make additional capital contributions to the Agency. JICA has

67 This was reduced from 43 countries, following the 2011 Bilateral Aid Review
68 DFID Global Partnerships Department, Operational Plan 2011–2015
69 DFID Statistics on International Development 2013, p27
70 DFID Statistics 2013, p72
71 JICA Annual Report 2012, p18
received a Government of Japan contribution every year since 1965. JICA also raises
money from the markets. Since its reorganisation in 2008, JICA has been issuing bonds to
institutional investors and has recently issued bonds to the retail market.²²

**Germany**

31. Germany’s ODA in 2012 was £8.3 billion, representing 0.38% GNI.³³ OECD reports
that Germany remains committed to the EU target of giving 0.7% of GNI as ODA by
2015.³⁴ Germany has recently negotiated a coalition treaty. There is reference to 0.7% in the
coalition treaty: there is a commitment to reaching 0.7% and therefore there is a need to
increase resources on an annual basis—this commitment would put Germany on a
sustainable financial path to reach the 0.7%. However, there is no agreed budget at the
moment. The preliminary numbers suggest there would be an additional €2 billion in aid
over the next four years, but this would not be enough to reach 0.7% (but rather something
below 0.6%). The German Federal Ministry for Economic Cooperation and Development
sets the political framework for development cooperation, GIZ deals with technical
assistance and KfW Entwicklungsbank (the KfW development bank, an integral, but small,
part of KfW Bankengruppe) deals with financial cooperation. KfW provides financing to
governments, public enterprises and commercial banks engaged in microfinance and the
promotion of small and medium enterprises in developing countries, and provides
different instruments according to the sector, the nature of the projects and the needs of its
partner countries. It provides loans close to market terms using its own resources
(promotional loans); soft loans that blend KfW resources with support from the federal
government’s aid budget (development loans); and highly subsidised loans and grants from
the federal aid budget. KfW lends mainly to the public sector, but sometimes also to the
private sector, via financial intermediaries such as its DEG subsidiary.²⁵

32. Germany used to provide the majority of its ODA as grants, but is now increasingly
providing loans. Dorothee Fiedler, Deputy Director General at the German Federal
Ministry for Economic Cooperation and Development, explained that this was because of
the increasing wealth of many of its partner countries; the German Government
considered that loans could be much more efficient and effective, and that it was possible
to get more developing country ownership from loans.²⁶ Dorothee Fiedler told us that
there had been a big increase in the amount of funding provided by KfW to developing
countries, because of its ability to raise money from the market. She also said that
developing countries came to KfW for its special expertise, not just its money, and that this
technical expertise was a particular feature of a development bank, rather than a bank
which just gave out grants or loans.²⁷ Marc Engelhardt, Director of Development and
Climate, KfW Development Bank, said that a really big advantage of a development bank
was its holistic assessment of projects, and the bringing together of banking and

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³³ DFID Statistics 2013, p72
³⁴ www.oecd.org/dac
³⁵ Q 111
³⁶ Q 108
³⁷ Q 94
development perspectives in one institution which enabled it to share a wide range of expertise.\textsuperscript{78}

\textbf{France}

33. In 2012, France’s ODA amounted to £7.6 billion (0.46\% GNI),\textsuperscript{79} and it has reiterated its commitment to reach the 0.7\% target by 2015.\textsuperscript{80} However, according to the OECD, French ODA as \% of GNI is 0.46\%. At present, the commitment to spend the equivalent of 0.7\% of the French GNI on ODA is not part of the national budget for 2014 which is being negotiated at present. A report of the French Court of Audit\textsuperscript{81} published in June 2012 suggests that, based on the assumption that France’s GNI will amount to €2,489 billion in 2015, an increase of €8.76 billion from current levels (2011) would be necessary between 2012–2015 to reach the 0.7\% objective. This would represent an annual increase of 20\% in each of the four years, which has been achieved in the past thanks to debt cancellation, but looks unlikely in the years to come. Coordination Sud\textsuperscript{82} (the French equivalent of BOND) published a report in September 2013 highlighting that ODA allocations are 3.1\% lower in the 2014 budget proposal compared to 2013. On 11 December 2013, the French Development Minister presented a legislative proposal for a law programming and guiding policy priorities of development cooperation to be debated in Parliament early 2014. The commitment to spending 0.7\% of GNI on ODA is not among the priorities in this proposal and civil society has criticised the fact that this commitment is only lightly referred to in the text. Around 31\% of French ODA is provided through Agence Francaise de Developpement (AFD), France’s development bank, which is owned by and pays dividends to the French Government. It operates under the remit of the French Ministry of Foreign Affairs, the Ministry of Finance, and the Ministry of Overseas Territories. AFD is licensed and regulated by the French Banking Authority and conforms to national and international banking regulations. AFD’s ability to raise low-cost funding from financial markets and to design innovative co-financing arrangements allows loan recipients to benefit from AFD’s leverage, achieving an economic return on their investments that exceeds the cost of their debt. AFD also processes some grants on behalf of the French Ministry of Foreign Affairs, but these are relatively few. These grants are funded by the interest payments received from AFD loans. AFD currently provides very little technical assistance.

34. AFD provides sovereign loans to countries with low levels of debt that are in a position to borrow. It also provides non-sovereign loans to state-owned companies, local authorities, public establishments, NGOs and the private sector. It allocates both market-rate loans (non-concessional loans) and subsidised loans (concessional loans). The subsidised element of concessional loans is provided by the French Government. Market-

\textsuperscript{78} Q 94
\textsuperscript{79} DFID Statistics 2013, p72
\textsuperscript{80} www.oecd.org/dac/france.htm
\textsuperscript{81} http://www.afd.fr/webdav/site/afd/shared/0L_AFD/I_AFD_s_engage/documents/rapport_public_politique_francaise_aide_publique_au_developpement.pdf
rate loans provide a response to a lack of liquidity and an urgent need for credit, and are destined for countries with low levels of debt and profitable projects to finance. AFD also provides equity, guarantees and subsidies. AFD has a branch, PROPARCO, which operates private sector financing, through loans and taking equity stakes in businesses in developing countries.83

35. We are disappointed that neither Germany nor France appear to have backed up their stated commitments to achieve the 0.7% GNI aid target by 2015 with the necessary allocations in their forward budgets.

DFID’s future strategy

36. The World Bank argues that aid has helped low-income countries to accelerate economic growth and lift people from extreme poverty, and that it will continue to be an important source of development financing for many countries. But with heavy fiscal pressures on major donors, constraints on the multilateral development banks, and a weak global recovery, the approach to financing development needs to evolve by bringing in more actors and instruments, while continuing to build on enhanced aid effectiveness.84 DFID has indicated that it is considering a number of options for introducing new bilateral financial instruments, including lending to partner governments and enhancing private sector flows. In its written submission, it explained that:

Lending could occur either on DFID’s balance sheet or through a separate legal entity, which could be a small-sized entity or a larger independent development finance institution. All of these options could lend to multilaterals such as the World Bank who then on-lend or to countries either by co-financing multilateral loans or as stand-alone lending.85

DFID said that the criteria being used to assess these options were development effectiveness; administrative requirements; potential demand; ODA and IDA frameworks; and the implications for Government expenditure and borrowing.86

37. One of the options would be for the UK Government to establish a UK development bank (UKDB) which could provide loans and other instruments to the public sector or the private sector, or both. We consider this in more detail in the following Chapters, looking first at the needs of the public sector, then at ways of supporting the private sector, and finally at the potential for a UKDB to meet these public and private sector finance needs.

38. The growth in sources and types of development finance mean that developing countries now have more choice and can in some cases elect to opt for finance which is delivered more quickly and with less conditionality than traditional aid. However, aid is still of critical importance, especially for reaching the very poorest people, for leveraging in other resources and for helping growth in low income countries. For some other major national donors, such as Japan, Germany and France, concessional loans

83 International Development Committee visit to Paris, informal meeting with CEO of AFD on 6 November 2012
84 World Bank Group, Financing for development post-2105, p ix
85 Ibid
86 Ibid
represent a significant part of their bilateral aid delivery. DFID must continue to evolve its strategy so that it continues to target its resources in the most effective way, including providing a combination of grant aid, loans and guarantees.

39. Development aid in the form of grants is very limited and precious and it is getting increasingly difficult to make the case for giving aid in the form of grants to MICs. We believe that DFID should also develop the capacity to distribute aid in the form of concessional and non-concessional loans either “in house” or by establishing a UK development bank. We recognise that it will take time to build the capacity to manage loan finance but the expectation, once the capacity has been established, should be that grants to MICs should only be used where no other form of finance is possible. There may also be circumstances where loan finance would be appropriate in low income countries, for example to finance infrastructure, such as power generation, which will generate a return on investment, but care should be taken not to re-burden least developed countries with unmanageable debt. We believe that grants should continue to be used for financing access to basic minimum needs in LICs like health, education, sanitation and water and where speed is of the essence, for example for emergency relief; for failed states and major conflict areas; and for global public goods which cannot be funded in other ways.
4 Lending to the public sector

Potential role for UK bilateral concessional loans

40. In this Chapter we consider the potential advantages and drawbacks of DFID providing concessional loans to partner governments. The International Development Act 2002 gives DFID the power to provide loans—a power which the UK Government used before the 1980s debt crisis—but the vast majority of UK bilateral ODA is currently provided in grant form.\textsuperscript{87} According to a recent analysis by Development Initiatives, only a small number of donors disburse significant amounts of bilateral ODA loans, with 90% of these in 2011 coming from Japan, France and Germany, and Japan’s loans being more concessional on average than those of France or Germany.\textsuperscript{88} OECD DAC regulations stipulate that “to qualify as ODA, a loan must include a 25% “grant element”, in comparison with a loan of similar nominal amount and duration carrying a 10% interest rate”. The term ‘concessional loan’ is often used more broadly to refer to loans which have preferential terms such as a lower interest rate and/or, a longer or more flexible repayment term, and to loans for projects with higher risks which would not attract market rate loans.

Potential advantages of concessional loans

41. Several witnesses said that loans had potential advantages, provided that they were carefully and appropriately targeted.\textsuperscript{89} There are many large public sector projects, particularly infrastructure projects in Africa, which require long-term financing, potentially in politically unstable countries, which is often not available, or affordable, through the market.\textsuperscript{90} A key benefit of concessional loans is the ability to mobilise large levels of upfront financial resources, with affordable terms and conditions, for these projects.\textsuperscript{91} Matthew Martin told us that many recipient countries were already using concessional loans and were also being pushed to fund infrastructure on much more expensive loans, such as borrowing on bond markets and doing off-budget PFI deals in an extremely high cost way. He added that the alternative of having lower cost concessional loans would probably be very welcome to them, and suggested that loans should be focussed on high-return projects, public-sector projects which had a high impact on growth and development, and where there was currently a real funding gap.\textsuperscript{92}

42. Other arguments offered in favour of loans are that they can help recipient countries improve their debt management capabilities; they can strengthen partnership and cooperation; they offer flexibility to meet specific project needs; and they can provide a way of offering a larger volume of funding and over longer term periods.\textsuperscript{93}

\textsuperscript{87} Ev 88
\textsuperscript{88} Ev w48
\textsuperscript{89} Eg Ev 92, Ev w10, Ev w5
\textsuperscript{90} Ev w 48
\textsuperscript{91} Ev 114 and Q29
\textsuperscript{92} Q 30
\textsuperscript{93} Note on development banks, Dirk Willem te Velde, Annex 2
Potential drawbacks of concessional loans

43. A key drawback of loans is the risk that they can lead to an accumulation of debt which, if not managed well, can threaten the future stability of vulnerable economies. Concessional loans can however help countries reduce their exposure to indebtedness by providing an alternative to riskier and more expensive loans. The TUC pointed out that an accumulation of debt could threaten the stability of vulnerable economies, but said that it had no objections to the setting up of a separate financial institution for concessional development finance if the new institution were to provide additional finance for development. However it also argued that concessional finance could be provided more effectively by other existing financial institutions.94 Peter Chowla, Coordinator, Bretton Woods Project, said that public-sector concessional loans “need to be carefully and strategically used for different kinds of things because of the debt-creating nature of them, the governance arrangements over how they are controlled, and potentially the purposes and strings that might be tied to them”.95 Richard Manning was of a similar view, saying that “To me, a critical issue is the proper use of these funds and whether we have a good system internationally for encouraging debt-creating flows to be used in a sustainable manner.”96 Investing in large public and private sector projects is not risk free: there are, sadly, many examples of poor use of aid in past years on private investments and large public sector infrastructure projects which failed to deliver long-term development benefits commensurate with their cost, but nevertheless left the countries concerned with high levels of development debt, which in the case of many least developed countries was eventually written off by donors.

44. Several witnesses mentioned complications with regard to the calculation of the ODA element of loans. Loan repayments count as negative ODA and so DFID would need to forecast these, as well as tracking new grants and loans, in order to monitor its total annual ODA contribution. Some experts have questioned whether the OECD DAC definition, requiring concessional loans to include a grant element of at least 25%, is applied sufficiently rigorously, and have suggested that this issue should be addressed in the ODA definition review being undertaken by the DAC Expert Reference Group on External Financing. Some question the current rule where countries which borrow at market rates in developed countries and on-lend to developing countries with a mark-up but below ODA rates, can count that finance as ODA. The TUC stated that “There is growing criticism of current methods of the degree of concessionality – grant element – of loans taken out by some developing countries from developed nations including France and Japan. In fact, the methods used by DAC tend to inflate the grant element significantly.”97 Richard Manning agreed, saying that “some countries are counting flows that are not really concessional because of how the OECD has chosen to [define ODA]”.98 Another issue raised by witnesses was the difficulty of tracking the development outcomes of loans. For example, the UK Aid Network and Bond maintain that any increase in the use of loans

94 Ev w1
95 Q 28
96 Q 2
97 Ev w1
98 Q 20
must be assessed against the risks which include “lack of transparency, lack of evidence of impact or very long evidence chains”.99

45. Diana Noble, Chief Executive Officer, CDC, cautioned against any rapid change of focus for DFID, saying that “It really takes time to scale up teams and strategies. The history of CDC shows that the biggest disasters happened when CDC rushed into a market too quickly, without really understanding what worked at small scale and before accelerating investment over time. One of the big challenges will be to resist the temptation to give a new team a big pot of money and incentivise them to spend it quickly.”100 Owen Barder argued against any major change of approach for DFID, saying that it should continue to focus on providing grants to the very poorest:

We have learned lessons about how to deliver aid effectively over the last 50 years. That means we should continue to do that, and not follow the new donors into less effective ways of giving aid. The fact that there are more people giving hard and concessional loans should focus us on the areas where aid can make most difference in grant form. I think we should resist the tendency to be pulled into doing more of what everybody else is doing, because if aid does not focus on the very poorest, most marginalised people, who will?101

46. The Secretary of State agreed that there was a need for greater clarity of the OECD DAC definition of concessional loans, and also for the accounting of other instruments such as guarantees.102 However, she expressed reservations about the option of UK bilateral loans in the immediate future saying that:

We do not have any plans to do any concessional loans directly to governments bilaterally. Our sense is that a more sensible route is to work with multilateral agencies, which often have the scale and reach, and can pull in not only other donor investment ... but also the private sector.103

The Secretary of State suggested that a multilateral approach was particularly appropriate for many of the infrastructure projects in Africa because “these are very big projects that no donor country could finance on its own or would want to finance on its own”.104 However, she indicated that DFID might consider providing bilateral loans on a case-by-case basis, and said that “there is a range of different mechanisms we can use in order to carry out investment. It is about finding the right one for the project”.105

47. There are many large public sector projects in the developing world which require finance. Concessional loans are one way of supporting such projects which have potential economic benefits for developing countries. They can offer benefits to donors in terms of recycling finance and leveraging additional finance; and to recipients in

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99 Ev w10
100 Q 177
101 Q 42
102 Q 231
103 Q 235
104 Q 236
105 Q 246
terms of offering a less expensive option to market loans. For concessional loans to be effective, donors need to have the appropriate skills and expertise to ensure that loan finance works properly and is used appropriately, so that projects are fully implemented and achieve the desired development impact; that the debt sustainability of the recipient country is not threatened; and that the loan is repaid.

48. The Secretary of State told us that DFID would continue to provide concessional loans where necessary through multilaterals, but that it had no immediate plans to start offering bilateral concessional loans. She also said that DFID might consider providing bilateral loans on a case by case basis. This ambiguity could be confusing.

49. We believe that there is a strong case for providing concessional loans, especially to lower Middle Income Countries. For example, DFID is working with the Indian Government on a programme to support the transition from a grant aid based relationship to one of mutual cooperation on trade and economic development. We believe that DFID should consider the scope for providing loans to regional governments within India as part of this transition programme, in order to support public sector projects in those regions which continue to have high levels of extreme poverty. This could provide a model for the transition arrangements for other middle income countries.

50. We recommend that DFID sets out criteria which it can use to judge whether it still has the most appropriate multilateral and bilateral instruments. Given the rapidly changing context, it should actively consider introducing new finance instruments, or it will risk reducing its effectiveness. We recommend that DFID includes an assessment of the following issues in its finance strategy:

- Is there a demand for bilateral concessional loans for public sector projects, and if so, from which countries and sectors?

- What additional skills and expertise would DFID need to provide and manage bilateral loans? What additional processes would it need to introduce?

- What are the relative merits of providing loans through multilaterals, and bilaterally? In what circumstances and for what projects would DFID consider providing bilateral loans?
5 Working with the private sector

DFID’s private sector strategy

51. Helping developing countries to build a stronger private sector can be an effective way of supporting economic growth and job creation and is a key part of DFID’s private sector strategy. The Secretary of State has highlighted the increased focus on private sector support in a number of recent speeches. This strategy is currently delivered through DFID’s bilateral programme, key multilaterals (including the World Bank, IMF and Development Banks), CDC and the Private Sector Infrastructure Group (PIDG). The DFID-funded Trademark East Africa is an example of a multi-sector, multi-donor initiative to boost prosperity. Both the State (through supply side strengthening via education, health, public infrastructure etc) and the private sector (through innovation, entrepreneurship, private investment, marketing etc) contribute to economic growth and therefore to providing employment and raising living standards. In this Chapter we consider whether these programmes could be strengthened by extending DFID’s range of bilateral finance instruments. For example, more finance provided as returnable capital, rather than grants, could potentially play a greater role in a future strategy, and repayments received from investments in successful private sector enterprises could be recycled and used to fund further ventures.

52. CDC is the UK’s development finance institution and is a major element of DFID’s private sector strategy. It is wholly owned by the Government, but operates independently under the governance of an independent board. CDC last received DFID funding in 1995, since when it has been self-sufficient, investing from its own balance sheet and recycling profits into new investments. It aims to invest in projects which are commercially viable and achieve a fair return on capital, but for which other commercial capital is not readily available, and for projects which will have a significant development impact, primarily by creating jobs. It takes equity stakes, both directly and through Fund Managers, and provides non-concessional loans to businesses in developing countries.

53. In 2011, we conducted an inquiry into the future of CDC and recommended making a number of changes to CDC’s structure and remit so as to achieve a greater focus on development impact. Since then, CDC has created two new teams to invest equity directly in business and to provide debt and structured finance. It has also created a tool to help it direct capital to investments which have the greatest chance of creating jobs, especially in the most difficult areas. Although we recommended that CDC make changes, we also advised it to be cautious about taking on too many new roles and diversifying its investment tools too rapidly, and recommended that CDC work alongside

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107 Returnable capital is a term used to refer to loans, equities, guarantees and other similar financial instruments

108 Ev 92


110 Q 156
the other development finance institutions to provide the range of tools needed by developing countries.

54. In December 2012, DFID launched a £75 million Impact Investment Fund under the management of CDC, with the aim of investing in impact investment intermediaries that provide capital to businesses and projects which improve the lives of poor people in sub-Saharan Africa and South Asia. Backed by expert technical assistance, the Fund is designed to attract new investors to promising impact investment intermediaries. In early 2013, CDC opened a ‘Request for Proposals’ process and received over 100 proposals from fund managers, holding companies, non-profit organisations and other investors. It then assessed the proposals in order to determine which would be selected for funding.

55. The Private Sector Infrastructure Group (PIDG) is another vehicle used by DFID for its private sector support. PIDG is a multilateral, funded by nine, mostly European donors. DFID was one of the original members, and makes the biggest financial contribution. PIDG has a number of specialised financing and project development subsidiaries which are designed to overcome the obstacles to generating private sector investment in infrastructure projects in developing countries, and which support projects across four continents and nine infrastructure sectors.

56. In our 2011 Report on DFID’s Role in Building Infrastructure in Developing Countries, we commended DFID for its role in establishing PIDG, and noted that for every £1 of aid funding, PIDG had brought in £20 of private sector capital. We recommended that DFID increase its funding of PIDG, which it has done, and that it consider how the model might be replicated in the agricultural sector. Since then, PIDG has acquired an affiliate, AgDevCo, which is a specialist provider of finance to smaller agricultural businesses in Africa, and is considering how best to develop the necessary sector skills to expand its investments in agriculture projects.

Benefits and risks associated with private sector support

57. Research indicates that partnerships with the private sector can be advantageous for donor organisations. Some of the reasons proposed for this are that businesses can help to direct the impact and to increase the scale and reach of donor activities; the private sector has developed management expertise and efficient operational processes which donors can harness or adopt to make their processes more efficient; businesses can play an important role in improving the local or national governance of the countries in which they operate; and private sector partners can provide a way of leveraging private financing through

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111 Impact investment is a term used to describe investments which are made with primary objectives of social or environmental impact, and may have a financial return below market rates.
113 Private Sector Infrastructure Group Annual Report 2012, p 16
114 DFID Annual Report and Accounts 2012–13, p89 reports that DFID funding to PIDG has increased from around £10m in 2009–10 to nearly £70m in 2012–13
115 International Development Committee, Ninth Report of Session 2010–12, HC 848, DFID’s Role in Building Infrastructure in Developing Countries, para 23
116 Q 161
public funds, in order to achieve developmental goals. 117 Graduation from aid to upper MIC status is typically associated with private sector growth.

58. However, witnesses commented that not all development goals, in particular those aimed at the very poorest people, are necessarily achieved via private sector engagement, 118 and that economic growth, whilst necessary, is not always sufficient to achieve a reduction in extreme poverty. 119 In addition, some witnesses said that private investment is primarily driven by profit rather than social benefit, and it can be difficult to achieve an appropriate balance between these different objectives. 120 For example, in our 2011 report on CDC, we noted that the commercial viability of its investments was of central importance, but recommended that CDC should allow for lower returns on parts of its portfolio in order to focus more on higher risk poverty alleviation projects. 121 Measuring the development impact of private sector investments is also difficult and not always well achieved, 122 and there is a need to develop indicators which capture wider benefits such as improved access to public services and improved productivity, as well as measuring the number of new jobs created. 123

59. Other issues mentioned by witnesses were the risks that providing concessional finance to the private sector could lead to market distortion, 124 and concerns about future debt sustainability. 125 Support for private sector businesses based in developing countries may take the form of contracting services from private sector suppliers, providing business loans or equity, or the improvement of public sector services—such as regulatory bodies (e.g. land registries), licensing, customs, trade promotion, courts and justice—or public sector infrastructure (e.g. rural roads, strategic highways, ports etc). There are concerns about providing UK aid to support multi-national companies or companies based in developed countries. When providing aid to the private sector great care needs to be taken to avoid giving one private company a competitive advantage over others, or aiding companies in which Ministers, public officials or members of their families have a financial interest.

60. It is important to be clear where public money (ODA) is likely to strengthen the private sector and where it risks compromising the useful free play of market forces. DFID has provided effective support for the private sector (establishing land registries, strengthening support for SMEs, capital markets, trade facilitation etc). However, there are potential dangers, notably in creating non-competitive businesses through public funding.

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118 Ev 94
119 Ev 48
120 Q 15 and Q 68
121 The Future of CDC, para 69
122 Q 35
123 Q 135
124 Ev 92 and Ev 100
125 Eg Ev 40
61. Witnesses pointed out the range of specialist skills needed to manage loans and to operate in different sectors. Edward Farquharson, Executive Director of the PIDG Programme Management Unit, explained that "If one looks at infrastructure, say, the skills needed for providing finance at the very early stage of a project’s life are actually very different and distinct from the skills needed to make senior debt loans to projects" and "we often talk about making loans and making investments. It is also about getting them back and therefore the skills needed to manage those portfolios and negotiate the issues where they arise during the life of the assets are equally important".\textsuperscript{126} Diana Noble, CDC, agreed saying that:

in the private sector the skills that are required here are to look at something that inherently does not make money today—it is uncommercial today, because otherwise it does not need concessional finance—but be able to think about what your money can do and what can be created in five to 10 years. That is a pretty high skill, to be able to judge whether your money is going to the right things and not the wrong things. I would definitely advocate thinking very carefully about the skills on the team that are necessary to deliver this plan.\textsuperscript{127}

\subsection*{Private sector finance needs}

62. Caroline Ashley, Director of Ashley Insight Ltd, suggested that there were three main areas in which concessional finance for the private sector could be useful: when the private sector venture generated real public good, but had a commercial return below market rate; as a temporary measure, to help a venture make the transition to become commercially sustainable; and in unstable countries where the political risk was deemed as high and the concessional finance could carry more of the risk.\textsuperscript{128} She also pointed to the need for a clear understanding of the development objectives, before identifying appropriate interventions and finance instruments. She explained that these could range from objectives focusing on ‘bigger’ (ie expansion of the private sector) to ‘better’ (ie harnessing private sector investment to tackle poverty problems), with some in the middle which promote more inclusive growth.\textsuperscript{129}

63. Advances in information and communications technology have supported the growth of micro-credit systems of support,\textsuperscript{130} but witnesses suggested that there was a lack of finance to enable small businesses to grow into sustainable enterprises. Philip Schluter, Managing Director of a coffee export business working with small farmers in a number of African countries, told us that:

the greatest need is to make finance available to smaller companies to fill the gap between microfinance institutions and the larger loans, which are typically taken up by the multinationals. There are some institutions beginning to fill this space, but there is still a large gap. Equity investments, with some risk-sharing would also be

\textsuperscript{126} Q 176
\textsuperscript{127} Q 190
\textsuperscript{128} Q 130
\textsuperscript{129} Ev 94
\textsuperscript{130} ODI, Inclusive and sustainable development, Norton and Rogerson, September 2012, p17
very welcome. Typically the places most in need of development are also those with the highest risks.\textsuperscript{131}

64. Dr Chris West, Director, Shell Foundation, agreed that the challenge was how to bridge this gap, saying that small businesses “hit this wall where there is no one with the risk appetite, patience and skill support to get them to the level where they can go on to the balance sheet of, for example, the EIB”.\textsuperscript{132} He added that different finance forms and flexibility were needed, and that existing development finance institutions did not provide this.\textsuperscript{133} Tamsyn Barton, Director General, European Investment Bank (EIB), said that development finance institutions like the EIB aimed to fill that space, but that it was very labour intensive, which was one of the reasons why multilateral administrative costs were relatively high.\textsuperscript{134} She suggested that “it is really a question of the mandate of the institutions, and the appetite of those putting in public money to provide the flexibility for it to play that crucial midfield role.”\textsuperscript{135}

65. Dr Chris West suggested that DFID needed to acquire more ‘business DNA’ which he defined as the ability to assess and take risk, to look at a market opportunity and provide the best form of product or service to satisfy it, so as to escape subsidy dependence and create something that can stand on its own feet.\textsuperscript{136} He added that investing in growing businesses required time and patience and that:

\begin{quote}
We need a project preparation facility, coupled with finance that will take a lower-yielding, marginal return on those deals, and leverage off that, and then bridge into other types of finance, which are amply developed. It is those two sets of DNA. At the moment, we have got one that is development DNA—grant based—and financial DNA.\textsuperscript{137}
\end{quote}

66. The Secretary of State told us that DFID had a number of ways of investing in the private sector, including its recently launched Impact Investment Fund.\textsuperscript{138} She also described a number of different ways in which DFID was supporting growth in developing countries including reducing red tape, streamlining customs processes, improving access to finance and microfinance, helping to encourage entrepreneurship and promoting responsible UK investment.\textsuperscript{139} She explained that DFID had a number of possible routes for extending its range of private sector financing, which could include new innovations with multilaterals, developing CDC’s remit or providing direct lending from DFID.\textsuperscript{140} The Secretary of State recognised that skills within DFID would need to change “to match a changing agenda”.\textsuperscript{141} On 31 January 2014 DFID launched its new economic development

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\textsuperscript{131} Ev 100 \\
\textsuperscript{132} Q 94 \\
\textsuperscript{133} Q 95 \\
\textsuperscript{134} Q 94 \\
\textsuperscript{135} Q 94 \\
\textsuperscript{136} Q 106 \\
\textsuperscript{137} Q 106 \\
\textsuperscript{138} Qq 233, 234 \\
\textsuperscript{139} Q 248 \\
\textsuperscript{140} Q 234
\end{flushright}
strategy, which indicates that DFID has begun to identify some of the new types of financial instruments required to support development adequately.\footnote{33}

67. Supporting the private sector can have significant benefits in terms of boosting economic growth, creating jobs and raising incomes in developing countries and helping to deliver projects with other social benefits. Finance provided as returnable capital could potentially play a greater future role, and enable the finance which has helped businesses to become sustainable and profitable, to be reinvested in other projects. We think that there is significant scope for support to the private sector, but as such projects are expected to make a return, we recommend that when DFID is dealing with the private sector, the presumption should be that finance will be provided as returnable capital.

68. \textit{We welcome the launch of the Impact Investment Fund and ask DFID to supply further details of the role and operation of this fund, including details of whether finance will be provided as grants or loans or other instruments.}

69. \textit{We recommend that private sector support should be an integral part of DFID's finance strategy, and that support for the private sector could be scaled up. We recognise that this will require new skills. We recommend that DFID's finance strategy includes an assessment of the following factors:}

- How can DFID target its private sector support such that it supports inclusive growth?
- How can DFID assess and measure the development impact of its private sector support so as to take account of broader outcomes such as improved livelihoods, income growth and leverage, as well as jobs created?
- Should the remit of CDC be extended? Have the recent CDC organisational changes increased its development impact? Would bringing CDC under more direct DFID control improve DFID’s development impact?
- Can the success of PIDG be further extended or replicated for other countries and sectors?

We propose in a future inquiry to look at DFID’s private sector work.

\footnote{141}{Q 243}


6 A UK development bank

The potential role of a UK development bank

70. The UK is unusual in not having a development bank. Witnesses have suggested that there could potentially be a niche for certain bilateral financial products such as concessional loans, either for the public sector or the private sector or both. In Chapters 3, 4 and 5 we noted that despite the emergence of new sources of finance, there is still a need for different types of funding for development projects, and that for some of these projects, loans or other forms of returnable capital could potentially be more appropriate than grants.

71. Development banks provide credit and other financial services to individuals, firms and strategic sectors of the economy that private financial institutions are unable or unwilling fully to service. The world’s largest development banks include the China Development Bank, the Brazil Development Bank (BNDES) and the German Development Bank (KfW). At least thirteen G20 countries have some form of development bank, with combined assets amounting to more than USD 3 trillion. There are different options for development banks to fund their business operations, including taking savings and deposits from the public; borrowing from other financial institutions; raising money in the domestic or international capital markets; using their own equity; and receiving budget allocations from the government. Most development banks combine all these funding options. Development banks are expected to be profitable and financially sustainable, and can have specific or broad mandates. Development banks address market failures in the availability of long term finance, ensure that long term savings are allocated to the long term finance needs and can be used to raise funds on the capital markets and allocate those funds to developing countries. Development banks can also use innovative instruments to leverage funds from other sources, including private citizens and diaspora communities.

The table below shows the functions of existing development banks, indicating which financial instruments they provide and which fund public and which the private sectors as well as the functions a UK development bank might undertake.

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143 Eg Q 30, Ev 100
144 Annex 2
145 Annex 2
Table 2 Financial instruments of leading development finance institutions, including possible functions of a UK development bank

<table>
<thead>
<tr>
<th>Financial instrument</th>
<th>Finance for the public sector</th>
<th>Finance for the private sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concessional loans (ODA)</td>
<td>Bilateral: KfW (Germany), AfD (France), JICA (Japan) Regional: EIB, AsDB, AfDB Multilateral: IDA (World Bank)</td>
<td>Interest rate subsidies (eg by EIB) FMO(Netherlands) government funds JICA (private sector investment finance)</td>
</tr>
<tr>
<td>Non-concessional loans (Other Official Flows)</td>
<td>IBRD (World Bank) EIB AfDB, AsDB, EBRD, IADB KfW (promotional loans)</td>
<td>CDC’s new mandate allows loans (it also manages the Impact Investment Fund) EIB Bilateral: DEG (Germany), Proparco (France), core FMO Multilateral: IFC (World Bank)</td>
</tr>
<tr>
<td>Grants</td>
<td>IDA (World Bank) DFID</td>
<td>DFID challenge funds (eg AECF, TGVCI)</td>
</tr>
<tr>
<td>Direct equity and equity funds</td>
<td></td>
<td>CDC</td>
</tr>
<tr>
<td>Guarantees</td>
<td></td>
<td>UK export finance (ECGD) for UK exporters and investors MIGA (World Bank)</td>
</tr>
</tbody>
</table>

Abbreviations:


**Potential benefits of a UK development bank**

72. In order to assess the potential benefits of established a UKDB, there are a number of questions which would first have to be considered. These include whether the new instruments offered by a UKDB would be more effective in terms of fostering growth,
reducing poverty and addressing global public goods; whether there was a demand for the additional finance instruments which could be provided by a UKDB; what would be the additional benefits of setting up this new institution rather than providing instruments through existing entities; and how a new UKDB would relate to existing UK Government objectives, obligations and laws. The establishment of a UKDB could reduce the amount of ODA that the taxpayer would need to fund, if the bank raised funds from capital markets and if it were able to increase the value of its loan book. Holger Rothenbusch, CDC, pointed out that this was a model used by France and Germany, and which was compliant with the current calculation of ODA.148

73. Marc Englehardt, KfW suggested that having a UKDB would provide the potential for new joint ventures between DFID, KfW and other donors, and that the UK “would be a highly welcome partner, as an additional European development bank in EU blending”. Professor Griffith-Jones agreed, saying that KfW, AFD and EIB had an informal consortium where each one took a lead in particular projects, and that the model could perhaps be replicated with a UKDB joining them”. JICA indicated in informal meetings that it would be interested in joint ventures with the UK; the establishment of a UKDB with a wider range of financial instruments could facilitate this sort of cooperation. Professor Griffith-Jones said that if a UKDB were to borrow money, it could borrow more cheaply and transfer that cheapness to developing countries. Diana Noble, CDC, suggested that a UKDB could play an important role “but not obviously at the expense of retaining a significant aid budget. There will always be areas of public sector good that can only be funded through grants.”

74. In addition, the creation of a new UK institution with the capacity to provide a range of bilateral finance instruments and technical assistance and the ability to work in partnership with other development banks and multilaterals could enable it to deliver a range of longer term support to build on its humanitarian and rapid response to emergencies, such as that to Typhoon Haiyan in the Philippines. The Philippines is a lower middle income country with which the UK has no bilateral aid programme. It will need substantial investment to enable it to rebuild essential infrastructure and services. DFID has promised to assist in the reconstruction of the Philippines; the technical assistance, guarantees and loan finance which will be needed might best be delivered through a development bank.

147 Annex 2
148 Q 184
149 Q 104
150 Q 29
151 Q 36
152 Q 177
153 DFID Press Release, 24 December 2013, British support for reconstruction and recovery to help rebuild homes in the Philippines and get people back into jobs
**Potential drawbacks**

75. Several witnesses raised the question of the setup costs and effort of establishing a new UKDB. Matthew Martin suggested that, given the current severe budget constraints, setting up a whole new UK development bank institution “would seem really likely to undermine public support for development assistance in this country.” Andrew Rogerson, ODI, said that DFID would need to be very careful not to lose its current advantage of “combining a very large portion of the UK’s external aid effort under one roof and then being present in-country with that same sort of unified voice”. He added that:

> We should be careful. If the answer to a problem is concessional loans or guarantees, then DFID already has the powers ... but it should be very careful not to throw away that advantage by creating something apart from DFID that then adds to the general fragmentation in-country and does not necessarily dovetail with how taxpayers’ money is being used in other forms.

Concessional loans potentially have their place, and the world will probably need more of them, including through IDA, the EIB and other people you will be talking to, but not necessarily as a free-standing, brand-new bank that one would magic up, with all the transaction costs that might involve.

76. UKAN and BOND argued that evidence from other OECD development finance institutions suggested that their priorities and performance measurements were more often weighted towards financial return and evidence of contribution to financial growth rather than social development impacts. Peter Chowla questioned the capability of a new UKDB to focus, control and monitor the development outcomes of its investments, saying that:

> I am very, very wary about setting up new institutions thinking that the UK could become a model provider so quickly, because it is really complex, particularly where you are doing things like private-sector work or project work on the grounds that you are doing loans for these things. The social and environmental safeguards are really complex and the need to have people on the ground to monitor, supervise, course-correct and take feedback, and even project design at the very beginning, is very intensive.

77. Other witnesses suggested that a UKDB would not necessarily be responsive enough to meet the needs of developing countries. Adam Smith International said that development banks tended to be slow and risk-averse and overly focused on process. Matthew Martin suggested that low income countries would rate bilateral development banks and development financing institutions “in the last place” and would prefer donors instead to

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154 Eg Q 29 and Ev 114
155 Qq 30, 31
156 Q 51
157 Ev w12
158 Q 29
159 Ev 102
give good replenishments to existing multilateral institutions.\textsuperscript{160} The TUC expressed doubts about the wisdom of establishing another development bank when there were already a considerable number in existence.\textsuperscript{162} UKAN and BOND concluded that “there is currently insufficient evidence to suggest that a new UKDB or loan facility would provide true development additionality or that it would be an effective modality to deliver UK aid”.\textsuperscript{162}

Other options

78. Witnesses commented on some of the alternatives to a new UKDB. Caroline Ashley suggested that DFID had five broad options for managing an expanded range of development finance: running it from within DFID; contracting out programmes to external organisations; expanding the focus of CDC; setting up a development bank; and channelling money via multilateral institutions, and described some of the main advantages and disadvantages of each option.\textsuperscript{163}

79. Matthew Martin proposed that DFID could create an implementing agency within DFID, which would act as a virtual bank, and assess credit-worthiness, provide grants, loans and equities and organise co-financing with other organisations:

> For me, you could have something that I would call a “virtual” bank, where you would say, “DFID will now lend money for the countries that can afford it and for high-return projects,” but keep it within the programming and planning framework of DFID. The goal would be poverty reduction, funding the private sector, making sure it is untied and focusing on DFID’s key countries, and bringing in the idea that you would then co-finance, so you would need less investment and a huge amount of extra staff capacity and overheads within DFID. That would seem to me to be an ideal midway solution that one could adopt.\textsuperscript{164}

However, Tamsyn Barton questioned whether such an arrangement would provide DFID with the necessary expertise, and stressed the need for appropriately skilled staff to be available throughout the duration of the loan period.\textsuperscript{165} Another option would be to expand the remit of CDC. Diana Noble said that if a separate UKDB were established, “there would need to be a huge amount of cooperation and clarity between the institutions [CDC and the UKDB]”, and that “we at CDC would be extremely cooperative, constructive and helpful”. She explained that “If it [the UKDB] is outside CDC, it would be very important to have absolute clarity of mission between the two organisations to avoid confusing the market and creating unhealthy competition between teams”.\textsuperscript{166}

\textsuperscript{160} Q 27  
\textsuperscript{161} Ev w1, Ev 102  
\textsuperscript{162} Ev w12  
\textsuperscript{163} Ev 98  
\textsuperscript{164} Q 30  
\textsuperscript{165} Q 112  
\textsuperscript{166} Q 177
In terms of DFID’s current range of instruments, the Secretary of State made it clear that in the case of countries such as India which were transitioning from grant based bilateral country programmes, DFID aimed to use a range of different finance instruments, including loans as well as grants. For example, a portion of DFID’s recently launched Impact Investment Fund is available to invest in businesses which focus on pro-poor projects in India. The Secretary of State told us that:

It is quite right that we are starting to transition our relationship with the Indian Government on to one where we provide technical support. We move steadily from an aid-based relationship with them to trade-based. ... DFID has a role to play in that transition ... by steadily moving away from aid on to a more technical assistance, returnable capital basis, where it is not pure grants.

More generally, she explained that DFID was reviewing its investment policies and instruments, including the possibility of using more loans and that “it may well be that the most effective thing for us to do is to see whether we can achieve those outcomes through existing channels.” She also told us that “any move to set up a development bank is not going to happen overnight. It is a significant undertaking. ... I would describe any discussions around setting up a development bank as at a very early stage.” Professor Dercon said that the case for either lending instruments or a development bank was “clearly something that we have to keep live and keep on thinking about. ... The choice at the moment to be a bit cautious and not jump into it seems to be the right one.”

The UK is unusual in the G20 in not having its own development bank. Establishing a UK development bank could give the DFID bilateral programme a way of providing a wider range of finance instruments, to complement its grant aided programmes which we would expect to continue for the poorest countries. A UK development bank could offer a range of new instruments, including concessional loans, together with technical expertise which is often valued as much as finance. However, there is a real danger that establishing a new UK development agency outside DFID would fragment UK development policy. Great care would need to be taken to avoid this danger and to ensure that a new development bank would work closely with existing institutions.

We recognise that establishing a new UK development bank would be a major undertaking, which would need careful planning and a measured implementation, but believe that DFID should plan for the long term. Creating new institutions is challenging but not impossible; for example the Government has created the Green Investment Bank in less than three years. The ‘do nothing now’ option carries the risk that DFID’s bilateral approach becomes less effective over time and that it is unable to play a key role in the future.

167 Q 220
169 Q 220
170 Q 238
171 Q 237
172 Q 239
83. We recommend that DFID establish a financial instrument team that can prepare a development finance strategy; coordinate the various finance initiatives that are currently being piloted by DFID; draw together the different bilateral and multilateral approaches; design new instruments and build up the necessary skills for future innovation and development. Without this effort, DFID may not be in a position to establish a development bank if and when it were deemed advantageous to do so.

84. We recommend that DFID considers the following questions in its finance strategy:

- What are the development financing gaps in terms of instruments, sectors and countries? What niche could a new UK development bank fill? Would the new instruments be more effective in terms of fostering growth, reducing poverty and addressing global public goods?

- What would be the potential advantages and disadvantages of establishing a UK development bank? What could be achieved, or achieved better, through a new UK development bank compared to existing institutions? What comparative advantages would a UK development bank have over existing institutions?

- What are the pros and cons of other alternatives, including no change; developing closer working arrangements with multilaterals; providing concessional loans through the existing DFID structure; and expanding the scope of CDC?

- How would a UK development bank cooperate with other UK finance institutions and other development finance institutions?

- What are the institutional and legal issues which would need to be addressed?

- What would be the costs and possible timetable for establishing a UK development bank?

- What new skills would DFID need to acquire and how would it do so?

- What is the potential role of new finance instruments, such as Development Impact Bonds and Diaspora Bonds?
7 Global partnerships

Relationships with multilaterals

85. We have noted in previous Chapters that different multilaterals use a wide range of finance instruments, and have specialist skills and experience of using these in different countries and sectors. One option open to DFID would be to channel more of its finance through multilaterals, rather than attempt to replicate this diversity in its bilateral programmes. DFID delivered 43% of its total programme expenditure in 2012–13 through central funding to multilateral organisations, and 38% of its bilateral spending was also delivered through multilateral organisations.173

86. Some witnesses pointed to the relative strengths of multilateral organisations. Oxfam GB suggested that DFID should wherever possible fill any funding gaps via multilaterals, because “aid delivered via multilateral organisations can have cumulative lower transaction costs, reduce fragmentation, tackle global problems, and provide support for global public goods that cannot be addressed by bilateral aid”.174 Professor Dercon commented that action on global public goods, almost by definition, was often best addressed through multilaterals and partnerships.175 Owen Barder suggested that the case for multilateral support was becoming ever stronger in the changing development world:

in the world we will see in 30 years’ time, there is a stronger case for multilateralism, but there is also a stronger case for multilateralism right now. It is not just that because the world is changing we should be doing more multilaterally, but there are strong biases towards bilateralism that I think are unhelpful, and we should be, in any case, looking to spend more money through the multilateral system.176

87. However, bilateral programmes have the advantages of giving DFID greater choice in the focus, delivery and monitoring of outcomes, and DFID notes that it has more control over the types of programmes administered through its bilateral spend.177 DFID country teams running bilateral programmes are in a good position to influence multilateral programmes in that country. There are also concerns that administration costs are higher for multilaterals.178 We have noted in other Reports, the imperative of ensuring that any spending through multilaterals achieves value for money, and a key challenge for DFID is how to assess the performance of multilaterals in countries where DFID has no bilateral programme. We recommended in our recent report on the Multilateral Aid Review (MAR) that DFID should compare each multilateral organisation with bilateral alternatives as an integral part of the 2015 MAR. We also recommended that DFID put pressure on multilaterals to reduce their administration costs.179 The Secretary of State told us that

173 DFID Annual Report 2012–13, p 85
174 Ev w5
175 Q 255
176 Q 42
177 DFID Statistics 2013, p24
179 International Development Committee, Multilateral Aid Review, Fourth Report of Session 2013–14, HC 349, para 16
DFID had been looking at this over recent months in order to “try to get much more clarity around how you drive value for money and the comparative effectiveness of these different channels.”\textsuperscript{180} Professor Dercon explained that, in order to monitor the effectiveness of multilaterals, DFID’s approach was to get “very strong representation” within multilaterals, rather than trying to have a presence in the countries where projects were delivered.\textsuperscript{181}

88. One option open to DFID would be to channel more of its finance through multilaterals, and to make use of their wide range of specialist skills and expertise, rather than attempt to replicate all of these in its bilateral programmes. In order to determine the appropriate balance of bilateral and multilateral spending, DFID must be able to compare the relative outcomes and value for money of these different channels, both in countries where it has a bilateral presence and those where it does not. We reiterate the recommendation that we made in our recent report on the Multilateral Aid Review, that DFID develop mechanisms for comparing the relative effectiveness of bilateral and multilateral aid.

89. Whilst we recognize the strengths of multilaterals in some areas, we firmly believe that DFID must continue to maintain a strong bilateral presence in order to maintain the UK’s influence in individual countries, and to monitor the performance of multilaterals which the UK finances. DFID must also maintain sufficient influence within multilaterals in order to monitor and influence their spending priorities. We recommend that DFID explore the potential for embedding more DFID staff within key multilaterals, and for increasing the opportunities for sharing learning and experience with its partners.

\textbf{Partnerships with emerging economies}

90. DFID has identified the strengthening of its relationships with emerging powers on global development as one of its strategic priorities. Through this collaboration, it aims to make development assistance more effective and to enhance the development impact of investment in poorer countries. It lists its priority countries/regions as China, Brazil, India, South Africa and the Gulf.\textsuperscript{182} During our visit to Brazil, we were told that Brazil was keen to develop South-South cooperation,\textsuperscript{183} using Brazilian experience and expertise to address development challenges in developing countries, and that there was great demand for this. Brazil currently uses bilateral, trilateral and multilateral arrangements to share and transfer technical expertise in policy areas where it has already achieved domestic success and international recognition. This includes expertise in agriculture, food security, social protection, health and other sectors. Its structures and policy for international development cooperation are still under development, but it currently cooperates with more than 80 countries, mostly in Latin America and Africa, and there is the potential for DFID to work with Brazil so as to facilitate and strengthen its spread of development expertise, and to increase its impact on LICs.

\textsuperscript{180} Q 256
\textsuperscript{181} Q 258
\textsuperscript{182} DFID Global Partnerships Department, Operational Plan 2011–2015, Section 3
\textsuperscript{183} South-South cooperation is the sharing of knowledge and experience between South America and developing countries, particularly in Africa
91. As Brazil’s wealth has grown, DFID’s role in Brazil has changed. Its bilateral programme with Brazil was closed in 2004 and the current role of the small DFID team in Brazil is to work with Brazil on promoting poverty reduction in developing countries elsewhere. This is an integral part of DFID’s Global Partnership agenda which seeks to cooperate with key emerging powers to tackle poverty globally. During our visit to Brazil, we heard about a number of innovative projects and policy developments which could potentially be used as models elsewhere, and could in particular be of assistance to LICs. Some of these are summarised in Annex 3, to illustrate the potential for shared learning.

92. The Secretary of State told us that DFID had developed a very good working relationship with both Brazil and China, and that she co-chaired the Global Partnership for Effective Development Cooperation which was one of the mechanisms which had been established to improve the sharing of knowledge and to promote South-South cooperation.184 She said that DFID’s Brazil office had been “extremely good for broadening out our relationship with the Brazilian Government and for transitioning our relationship on development with Brazil.”185

93. We welcome DFID’s work on promoting South-South cooperation, as a complement to development finance efforts. Emerging economies, such as Brazil, have much to contribute to developing countries. DFID has only a limited presence in Latin America, and we recommend that it explores the potential for small DFID teams to work closely with multilaterals on specific projects, so as to benefit from their specialist knowledge and to contribute to its learning from emerging economies. We recommend that DFID establish an innovation and knowledge transfer unit which would be responsible for identifying good development practice and transferring relevant knowledge and experience to other projects and country programmes. We would expect the unit to be based in the UK, but to have sufficient capacity to deploy a few people to participate in and learn from country programmes, and to cooperate with the FCO where necessary. We also recommend that DFID explore ways of helping low income countries to share their knowledge and experience with each other.

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184 Q 262, 263
185 Q 264
8 Conclusion

94. An increasing number of people living in poverty are in Middle Income Countries, which should eventually graduate from traditional grant aid. Donors are likely to combine grant aid to the poorest countries with new forms of engagement in Middle Income Countries, including technical assistance, support to NGOs and loans. They will want to invest more in supporting South-South cooperation and they are also likely to spend more resources on global public goods. If DFID is to retain a leading role in this changing development world, and maintain its relevance, it will need to innovate in its use of development finance. DFID will need to think carefully about the balance between bilateral and multilateral aid, and about how to deploy new forms of finance.

95. DFID needs to have a more explicit overall strategy on what financial instruments to use when, how much in each case, to which countries, via which channels, under what circumstances, and what skills are required to use them effectively. It also needs to address how the UK can remain relevant for developing country needs, how it can remain an innovator in the provision of aid, what UK aid will look like over the coming decade, and its strategy for getting there. In particular, DFID will need to think carefully about whether and how to provide bilateral loans to developing countries. This will not be a process that can be done quickly, and will require a different set of skills. DFID will also need to consider the mechanisms which would be required for providing bilateral loans, including whether and under what conditions a development bank would be required. To do this effectively, we recommend that DFID develops a comprehensive statement and development finance strategy to define its future role and how it will be financed. This should take the form of a Development Finance White paper, to be published during 2014, which should, inter-alia, set out the contribution of DFID and its financial mechanisms can make towards addressing inequality, equalising opportunities so as to “Leave No One Behind”, as advocated by the High Level Panel.
Annex 1: Note on capital flows to developing countries

Note – Dirk Willem te Velde, ODI (10/11/2013)

The nature of capital flows to developing countries is changing. Aid is an increasingly small share of total capital inflows into developing countries although it can still be substantial for specific countries. The UK provides aid and other types of capital flows to developing countries (FDI, bank lending etc.) and these other flows were around 2.5 times larger than UK aid flows in 2011 and 3.5 times larger in 2012.186

The figures and tables below show that:

UK ODA now represents a fifth of all UK financial flows going to DAC countries in 2012 (figures 1 and 2).

In 2012, the UK’s ODA / GNI ratio (now at 0.56%) was nearly double the OECD DAC average (0.29%) (figure 2).

The combination of UK public and private flows (excluding remittances) to DAC countries reached 2.6% of UK GNI in 2012, and this was much more than the OECD average (figure 3), meaning that the UK is proportionally linked more to DAC countries through financial flows than the rest of the OECD.

Capital inflows to sub-Saharan Africa (SSA) are increasingly diversified (Table 1), and recovered rapidly after the financial crisis (esp. bond and equity flows).

For SSA: capital flows are increasingly in the form of diversified private capital sources. Private capital flows are greater than ODA, closely followed by remittances. (Table 2). Other aid-like flows also important (but not discussed in this note).

The UK is a leading foreign investor in Africa; the UK stock (i.e. accumulated flows) ranks third behind France and the US (Table 3).

The UK is the main sender of remittances from the EU to ACP countries (Table 4). The UK accounts for about 44% of remittances from the EU to the ACP countries and for 13% of the total remittances received by ACP countries. The World Bank estimates suggest that the EU accounts for about 30% of remittances to ACP countries.

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186 Given that different data sources might provide different data, care needs to be taken in the interpretation of results (although we stick to the most commonly used or official data sets).
**Figure 1: UK ODA is a third of all UK financial flows going to DAC countries**

UK all flows (public and private) / GNI: in 2012: 2.57%

UK ODA/GNI
2012: 0.56%

Sources: Table 2 in https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254277/Statistics on International Development 2013a.pdf Note: Private flows include direct investment, export credits, bank lending and other private flows (but not included are transfers to or by private individuals, e.g remittances)
Figure 2: The UK’s ODA / GNI ratio is nearly double the DAC average
Figure 3: All flows / GNI in UK higher than the DAC average

Source:
Table 1: Private inflows into SSA increasing


Table 2: Capital flows to Sub-Saharan Africa US$ billion

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Source: OECD, [www.oecd.org](http://www.oecd.org)
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Note: Eurostat values are provided in euro, while the World Bank values are provided in US dollars. The World Bank figures come from the World Bank 2010 Migration Bilateral Matrix using host and home country incomes as well as the migrant stock to estimate remittances.

Annex 2: Note on Development Banks

Note by Dirk Willem te Velde, ODI

Selected options and criteria for a new UK development bank / entity to provide concessional loans

Different options exist for an appropriate institutional setting through which concessional loans could be provided:

Continue with business as usual (enable others such as PIDG, EIB and IDA to provide concessional loans, perhaps with minor modifications)

A DFID unit using DFID’s balance sheet e.g. to provide small scale loans (incl. to private sector)

A separate financial and investment account as in new JICA (funded mainly by government, but also potentially through the market)

A specialised financial institution that combines grants, concessional loans to the public sector and non-concessional loans to the private sector, similar to AfD, which funds it operations in part from the market (and needs to comply by banking regulations)

A UK development bank, similar to the KfW development bank, which can borrow from the market

A UK national development bank (similar to KfW bankengruppe, parent of KfW development bank) where part is used for financing global development

Hybrids (e.g. a UK green investment bank that can address climate finance internationally)

The broad criteria to assess suitability of providing new financial instruments through a new UK entity includes the following questions:

Would the new instruments be more effective in fostering growth, reducing poverty and addressing global public goods?

Is there a demand for the instruments provided by a UK development bank?

What is the benefit of doing this via a new UK institution / entity as opposed to an existing institution/entity in UK or elsewhere, including the multilaterals?

How does it relate to existing (UK) government objectives, obligations and laws?

Introduction

State-owned financial institutions (SFIs) accounted for some 25% of total assets in banking systems around the world in 2009, and 30% in the European Union (Schmit, 2011).187 In BRICs, the market share is substantially higher.

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Development Banks (DBs) are typically the largest type of SFI and provide credit and other financial services to individuals, firms and strategic sectors of the economy that private financial institutions were unable or unwilling to serve to the extent desired by policymakers.

The world’s largest development banks include China Development Bank, Brazil Development Bank (BNDES), and Kreditanstalt fuer Wiederaufbau (KfW) in Germany. In terms of assets, they are larger than the World Bank. But they are not the only ones, a recent World Bank survey included information on some 90 development banks in 61 countries around the world.

This note covers:

The many differences amongst development banks
Development banks in the G20
Issues involved in setting up a development bank
The link between recent developments in debt
A brief description of JICA, KfW and AfD
An institutional context for providing concessional loans
Questions and criteria to assess suitability of a new UK development bank
Broad differences amongst development banks
DBs differ across a range of variables (Luna Martinez and Vicente, 2012)188:
Ownership structure (fully vs. partially owned by government)
Policy mandates (narrow vs. broad mandates)
Funding mechanisms (deposit taking vs. non-deposit taking institutions)
Target sectors and clients (narrow vs. wide focus)
Lending models (first-tier vs. second-tier)
Pricing of lending products (subsidized vs. market interest rates)
Regulation and supervision (special regime vs. same regime applicable to private banks)
Corporate governance (independent vs. government controlled boards)
Transparency standards (wide vs. limited disclosure)
Instrument, sectoral and geographical coverage

Typically DBs are institutions owned, administered, and controlled by the government, which provides the strategic direction of the DB and appoints their senior management and board members. But in other DBs the private sector can also take a managing part. There are different options for DBs to fund their business operations, including (i) taking savings and deposits from the public, (ii) borrowing from other financial institutions, (iii) raising money in the domestic or international capital markets, (iv) using their own equity, and (v) receiving budget allocations from the government. Most DBs combine all these funding options.

DBs are expected to be profitable and financially self-sustainable, and non-reliant on government subsidies or transfers to (partially) fund their operations. Sometimes, DBs – such as KfW in Germany - receive transfers from the government to fund interest rate subsidies to a particular type of borrower.

Mandates can be specific or broad. There are pros and cons in adopting narrow versus broad mandates. On the one hand, narrow mandates encourage institutions to adhere to their original mandates and gain specialization in their target market. Monitoring and performance evaluation becomes easier in DBs with a narrow rather than a broad focus. However, institutions with narrow mandates do not have the flexibility to target various sectors, in some cases limiting their ability to manage risk through diversification. SMEs constitute the type of client they are trying to serve and support. Some DBs lend first-tier (closer to customer, lower interest rates) others second-tier (to financial institutions, lower operation costs, lower NPLs, BNDES, KfW).

The provision of credit at subsidized interest rates by DBs has been a controversial issue. For some, this practice might undermine the solvency and profitability of DBs and distort the competitive environment. For others, the use of subsidized interest rates might be justifiable to support nascent enterprises provided that subsidies are transparent and used for their intended purposes.

**Development Banks in the G20**

At least thirteen countries of the G20 have some form of national development bank, with combined assets amounting to more than US$3 trillion (Table 1). In addition, France recently created a public investment bank (Banque publique d’investissement, BPI) with a capital of over €20bn, and the United Kingdom announced the creation of the UK Green Investment Bank. There are other national development banks, such as l’Agence Française de Développement (AFD), and other development banks that are oriented mainly towards official development assistance, national overseas development and fostering economic activity in developing countries and emerging economies.
Table 1 National development banks in the G20: is the UK the exception?

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<th>Country</th>
<th>Institution</th>
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<td>74.0</td>
<td>Aa3 A- AA-</td>
</tr>
<tr>
<td>Turkey</td>
<td>Kalkimna</td>
<td>1.5</td>
<td>1.3</td>
<td>BBB-</td>
</tr>
<tr>
<td>United States</td>
<td>Fedim Bank of the US</td>
<td>13.7</td>
<td>11.8</td>
<td>Aaa A++ AA+</td>
</tr>
</tbody>
</table>

Source: G20 documentation (group on financing for investment)

**Issues involved in setting up a development bank**

Establishing a DB involves a lot of activities. First, there are fiscal costs associated as most DBs are created through public funds. However, the leverage can provide an efficient use of public resources. Second, efficient institutional design, administrative procedures and good governance are needed to complement the private sector. Thirdly, it is also important to have knowledge of financial instruments, debt management techniques, development economics and impact assessments.

**Do development banks lead to more debt?**

National development banks can (i) address market failures in capital markets; (ii) act counter-cyclically. They can be seen as an allocating mechanism, allocating e.g. savings to investment projects. The investee will take on additional debt (often in combination with other financial instruments such as equity and guarantees). If this debt is managed well in a growth enhancing project, this will lead to economic growth, increased tax revenues and less debt in the future. However, not all debt is managed well which can lead to debt instability. This is why development banks tend to have criteria to lend only to those countries who with an ability to manage debt.189

Developing countries have recently developed an appetite for more debt to finance their growth potential. Public and private debt has increased in sub Saharan Africa in recent years (after periods of debt relief), while as % of GDP and exports have stabilised. Countries are taking on debt from China and have begun to issue bonds. The remarkable dynamism recently surrounding bond flows in Africa is one example. Bond flows to SSA were valued at US$ 6 billion in 2011 and experienced much dynamism into 2012 and 2013. Several African countries have now issued bonds and others are considering doing so in 2013. Bond yields in Zambia – where the US$ 750 million bond issue (to finance

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189 This is explained in more detail in: Baudienville, Brown, Clay, te Velde (2009) ‘Assessing the Comparative Suitability of Loans and Grants for Climate Finance in Developing Countries’ Report for DFID and DECC, prepared by the Overseas Development Institute. It addresses (i) Whether development finance experience of loans/grants is relevant for climate finance; (ii) What DFID can learn from other countries (iii) The appropriateness of loans vs. grants depending on sending/recipient country and project characteristics
infrastructure) in September 2012 was reportedly oversubscribed 15 times – were, at 5.4% lower than in some European countries (Greece, Portugal, and Spain) in the past year. Nigeria, Angola, Ghana, Kenya and Rwanda plan to issue US$ 4 billion of bonds together in 2013. A US$ 400 million bond in Rwanda in 2013 was over-subscribed 7 times. The bond would be used to finance transport services and infrastructure. The bond issue was discussed with the IMF.

**Figure 1** External debt in sub-Saharan Africa, as a percentage of exports

![Chart showing external debt in sub-Saharan Africa as a percentage of exports](chart1)

**Figure 2** Private sector external debt stocks, long-term (bn US$)

![Chart showing private sector external debt stocks, long-term in bn US$](chart2)

Source: WDI. SSA countries include: Angola, Cameroon, Cote d’Ivoire, Madagascar, Mauritius, Nigeria, Senegal, Tanzania, Uganda, Zambia, Zimbabwe.
Selected information on JICA, KfW and AfD

**JICA**

The current JICA was formed in October 2008 after a merger of:

Technical Cooperation of the existing JICA;

Loan Aid operation (ODA loans and Private Sector Investment Finance (PSIF) of the former Japan Bank for International Cooperation (JBIC), and;

A large portion of Grant Aid implementing operation of the Ministry of Foreign Affairs (MOFA).

JICA provides loans and private sector investment finance through the Finance and Investment Account. This is separate from the general account used for aid. JICA’s capital is funded mainly by the Government of Japan (GOJ). The GOJ may, when it finds necessary, make additional capital contributions to the Agency. JICA has received GOJ contribution every year since 1965. With a capital of JPY 7.5 trillion, the capital ratio of JICA’s Finance and Investment Account is of 74.5% (very high by development bank standards). The Finance and Investment Account has made profit, since FY 1997 (except in FY 2002). Unappropriated income must be fully accumulated as reserve “until it reaches the amount equal to the amount of stated capital allocated for the Account” (Article 31 (5), JICA Act).

The Finance and Investment Account undertakes financial cooperation operations by providing debt and equity financing. To undertake these operations, it raises funds by borrowing from the Japanese government under the Fiscal Investment and Loan Programme, borrowing from financial institutions, issuing FILP agency bonds, and receiving capital investment from the Japanese government. Issuing bonds enable JICA to raise funds directly from the public who then have a direct stake in development funding. JICA borrows some 10% of the total outlays from the market and the rest from other sources.
The KfW Entwicklungsbank (KfW development bank) is Germany’s development bank, an integral (but small) part of KfW Bankengruppe. It finances, advises and promotes development projects and programmes around the world. The KfW Entwicklungsbank provided a total of €4.5 billion in 2011 for projects and programmes in North Africa/Middle East, Asia/Oceania, Europe/Caucuses as well as Latin America.

As part of KfW Bankengruppe, the KfW Entwicklungsbank supplements funds from the federal budget with significant amounts raised through their own efforts. Some €2.6 billion euros was mobilised on the capital market. The KfW Entwicklungsbank combines the expertise of a bank with a clear development-policy orientation. In German Financial Cooperation (FC) by the KfW Entwicklungsbank uses funds provided out of the federal budget and adds funds raised in the capital market ("KfW funds"). Currently two Euros out of every three spent on development projects in other countries come from KfW’s own funds.

The history of the KfW Entwicklungsbank is linked to the formation of the German Federal Ministry for Economic Cooperation and Development (BMZ). As early as 1952 - four years after the Kreditanstalt für Wiederaufbau (KfW) was founded and endowed with Marshall Plan funds - the Federal Republic of Germany provided development assistance in the form of financial participation in the so-called ‘extended support programme of the United Nations’. Development policy became a federal task and was given administrative and political expression in 1961 with the creation of the BMZ. Since then, KfW has been responsible for German Financial Cooperation (FC), or capital support.

Table 2 Commitments by KfW Development Bank 2009-2011 (in million euros)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total commitments1</td>
<td>3,482</td>
<td>4,452</td>
<td>4,532</td>
</tr>
<tr>
<td>FC grants</td>
<td>1,112</td>
<td>1,0363</td>
<td>1,336</td>
</tr>
<tr>
<td>FC loans</td>
<td>230</td>
<td>179</td>
<td>145</td>
</tr>
<tr>
<td>FC development loans</td>
<td>878</td>
<td>2,142</td>
<td>1,713</td>
</tr>
<tr>
<td>of which budget funds</td>
<td>106</td>
<td>215</td>
<td>134</td>
</tr>
<tr>
<td>FC Promotional loans</td>
<td>1,151</td>
<td>1,913</td>
<td>996</td>
</tr>
<tr>
<td>Delegated cooperation2</td>
<td>111</td>
<td>183</td>
<td>3434</td>
</tr>
</tbody>
</table>

Memo item: total budget funds

1,448

1,430

1,614

190 This section depends on information from KfW’s website, see e.g. https://www.kfw-entwicklungsbank.de/International-financing/KfW-Entwicklungsbank/About-us/Unsere-F%C5%BCrderinstrumente/

191 In 2012 KfW Bankengruppe committed a total financing volume of €73.4 billion. It was active mainly nationally. However, the KfW’s largest subsidiary, KfW IPEX Bank GmbH, lends predominantly internationally. A smaller subsidiary, the DEG, and one of the group’s smaller business units, KfW Development Bank, are exclusively active in the international arena, each within their particular business areas. KfW banking group covers over 90% of its borrowing needs in the capital markets, mainly through bonds that are guaranteed by the federal government. This allows KfW to raise and lend funds at advantageous conditions.
Differences compared with previous years due to interest grant adjustments.

Excluding intermediary funds: 2011 (73 million euros) 2010 (10 million euros) 2009 (233 million euros)

Includes 14 million euros in grants from the budget of the Federal Ministry for the Environment

Includes 84 million euros in grants from the budget of the Federal Foreign Office

Differences in the totals are due to rounding.

KfW Entwicklungsbank provided €2.7 billion in the field climate change and protecting the environment (or 60% of the total). Some €1.4 billion was allocated for "social infrastructure" (31 per cent), of which €750 million supported the improvement of water supply and guaranteed environmentally sound sewage disposal as well as solid waste management. KfW provided around 1.1 billion euros for the "financial sector" in its partner countries (25%). Of this figure, the majority of the funds supported small and medium-sized enterprises. Around €1 billion was allocated to the "economic infrastructure" (23% of total).

KfW Entwicklungsbank (KfW Development Bank) provides financing to governments, public enterprises and commercial banks engaged in microfinance and SME promotion in developing countries. It does so through:

- Loans close to market terms using its own resources (so-called promotional loans);
- Soft loans that blend KfW resources with support from the federal government’s aid budget (so-called development loans), and;
- Highly subsidized loans (grants and/or loans at advantageous IDA/standard conditions) and grants (both entirely from the federal aid budget).
Different country groups are offered different financing conditions depending mainly on their per capita income. In German aid, the work of KfW Development Bank is called “financial cooperation” which is complemented by “technical cooperation” by GIZ and other public agencies (see figure below). The loan conditions are tailored to the sector, the nature and cost-effectiveness of the project, the economic situation of the given partner country, its level of indebtedness and its state of development.

**Agence Française de Développement (AFD)**

Agence Française de Développement (AFD) is a public industrial and commercial entity and a specialized financial institution combined. AFD is wholly owned by the French state, operating under the remit of the French Ministry of Foreign Affairs, the Ministry of Finance, and the Ministry of Overseas Territories. As a bank and specialized financial institution, AFD is licensed and regulated by the French Banking Authority and conforms to national and international banking regulations (incl. ratios). AFD’s ability to raise low-cost funding from financial markets and to design innovative co-financing arrangements allows loan recipients to benefit from AFD’s leverage, achieving an economic return on their investments that exceeds the cost of their debt.

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192 The information in this section depends on the AFD website and related documents (incl. annual report)
**Funding model**

The AFD raises funds in international financial markets. AFD finances its operations and lending activities through internally-generated revenues, public bond issues and private equity investors. It leverages its AA+ credit rating to provide loans at better-than-market rates and conditions. The French Government also contributes funds. Funding from the Ministry of Foreign Affairs allows AFD to provide grants and subsidies for projects, including so-called “co-development” projects: these combine official development assistance with the funds of France-resident migrants, targeting both toward investments in migrants’ countries of origin. Funding from the Ministry of the Economy and Finance serves primarily to subsidize loans, while the Ministry of Overseas Territories supports overseas province development. In 2011, these French ministries provided AFD with €953 million towards its development projects and programmes this amount included €631 million of grant monies.

**Instruments**

The AFD has considerably scaled up its financing volumes in recent years in order to offset the drying up of private resources. Thanks to its Standard & Poor’s AA+ rating—(and Moody’s and Fitch’s AAA)—the highest possible rating for long-term loans—AFD can allocate loans to beneficiaries with more favourable terms than those offered by markets. AFD loans can be allocated to a State or a public entity benefitting from a State guarantee ("sovereign loan"), or an actor (business, private or public entity) that does not benefit from such a guarantee ("non-sovereign loan").

Sovereign loans: taken out or guaranteed by States and destined for countries with low levels of debt that wish or are in a position to borrow. They also concern countries with debt that has returned to a low level following a programme to alleviate their debt (HIPC Initiative). This is, for example, the case of Cameroon, Ghana or Senegal.

Non-sovereign loans: they are rising sharply and are destined for state-owned companies, local authorities, public establishments or NGOs. AFD also allocates subsidized loans to the private sector. For example, some public service missions are sometimes carried out by the private sector. Businesses often replace the State by providing social services to their employees when public authorities are unable to do so. AFD encourages these players to take part in development by allocating them financing with attractive terms. AFD has raised its capacity to allocate non-sovereign loans at its own risk, without guarantees from the relevant States. The size of loans to finance mega infrastructure operations implemented by the private sector is constantly rising.

The AFD allocates both market-rate loans (“non-concessional loans”) and subsidized loans (“soft loans”).

Soft loans: AFD may subsidize the financial conditions of a loan. The subsidy, which corresponds to the difference in rate between a market-rate loan and a soft loan, is subsequently provided by the French Government Market-rate loans: AFD has started extending its activity for market-rate loans at the request of its partners and in view of the crisis. These loans are destined for countries with low levels of debt and counterparts with profitable projects to finance. They provide a response to the lack of liquidity caused by the crisis and the urgent need for credit. For example, AFD has allocated its first market-rate
sovereign loan to Senegal in order to help its public finances recover. The Pointe Noire Port Authority in Congo has also benefited from a market-rate loan to finance its priority investments.

The conditions for these loans are also defined on the basis of:

The nature of the project (its social, environmental and economic impacts);

The status of the borrower (its business sector, ratings, guarantees), and;

The environment of the project (political, economic, social and environmental context).

AFD also provides equity, guarantees, and subsidies. The distribution is as follows:
The institutional context for concessional loans

The UK currently does not provide concessional loans, although it used to provide sovereign loans in the past. However, after the 2011 review of CDC, it can now provide non-concessional loans to the private sector. The question now is whether the UK also wants to provide concessional loans to public or private sectors, and non-concessional loans to the public sector, complementing the work by others.

The institutional framework is changing and includes bilateral, regional, multilateral and domestic institutions (bilateral European banks, EDFIs, EXIM banks; IDA/IFC; a planned BRICs bank, philanthropists, “impact” investors, etc).

Table 3 provides possible options for the location of a UKDB and how other institutions are located in this space in broad terms.

Table 3 Possible locations of a UKDB in the (public) institutional development financing framework; illustrative examples

<table>
<thead>
<tr>
<th>Public sector</th>
<th>Private sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concessional loans (ODA)</td>
<td>Bilateral: KfW, AfD, JICA Regional: EIB Multilateral: IDA UKDB?</td>
</tr>
<tr>
<td>Non-concessional loans (OOF)</td>
<td>IBRD EIB AfDB, AsDB, EBRD, IADB KfW (promotional loans) UKDB?</td>
</tr>
<tr>
<td>Grants</td>
<td>DFID</td>
</tr>
<tr>
<td>Direct equity and equity funds</td>
<td>CDC</td>
</tr>
<tr>
<td>Guarantees</td>
<td>UK export finance (ECGD) for UK exporters and investors MIGA</td>
</tr>
</tbody>
</table>

There are by now good overviews on DFIs that cater for the private sector (e.g. IFC, CDC. DEG), see Kingombe et al (2011)193 but there is less on DFIs/development banks that cater for the public sector (incl. through concessional loans), apart e.g. from Luna Martinez and Vicente (2012).

There are various options in terms of institutional settings through which concessional loans could be provided:

Continue with business as usual or with minor modifications (enable others such as PIDG, EIB and IDA to provide concessional loans)

A DFID unit using DFID’s balance sheet e.g. to provide small scale loans (incl. to private sector)

A separate financial and investment account as in new JICA (funded mainly by government, but possibly also be the market)

A specialised financial institution that combines grants, concessional loans the public sector and non-concessional loans to private sector, similar to AfD, which funds it operations in part from the market (and needs to comply by banking regulations)

A UK development bank, similar to the KfW development bank, which can borrow from the market

A UK national development bank (similar to KfW bankengruppe, parent of KfW development bank) where part is used for financing global development

Hybrids are possible. For example, the planned UK green investment bank could be provided with an ability to finance abroad. The UK Green Investment Bank has received £3 billion from the UK government [http://www.greeninvestmentbank.com/](http://www.greeninvestmentbank.com/). There had been question on whether it could borrow on the market, but the UK HMT blocked this option, see e.g. [http://www.e3g.org/programmes/systems-articles/uk-green-investment-bank/](http://www.e3g.org/programmes/systems-articles/uk-green-investment-bank/).

The above options will need to be assessed on the basis of criteria (see next section).

Questions and assessment criteria

There is potentially a niche for certain financial products such as concessional loans, but the following questions will need to be considered before establishing a UK development bank.

What are the development financing needs?

What are the gaps in instruments (increasing choice and demand for different instruments in developing countries? By both public and private sector actors; bond financing; economics of loans vs. grants; demand is in financing packages)?

What are the gaps in sectors (some sectors need long-term or large up-front financing, e.g. infrastructure; some sectors need special attention because of specific effects, social enterprises)?

What are the gaps in countries (changes in ability to manage loans vs. grants etc.; market access; debt sustainability; MIC financing gap after graduation)?

What would be the pros and cons of a UKDB? Can it fill a niche?

Instruments (loans vs. grants, and other; concessional vs. non-concessional loans)

Sectors (e.g. infrastructure, climate change, agriculture, innovation)
Countries (fragile, LICs, MICs, SVEs)

Can a UKDB build on comparative / competitive advantages vis-a-vis other institutions (table 2)

Home country advantage in being close to UK private sector (but not tied)

Home country advantage in being close to UK financial institutions (e.g. London city with available financial skills)

Overall portfolio advantages (triple AAA status? Using low interest rate in UK to get high returns in high growth countries, so good for sending and receiving countries)

Advantageous funding models (access to wholesale funding markets; access to offshore funds which otherwise would remain idle?)

Comparative advantages in terms of transaction costs

Disadvantage in pooling / scaling / fragmentation

Flexibility / innovative capacity (e.g. helping social enterprises)

Existing partnerships with Commonwealth and “other affiliated” countries

Institutional and legal questions for a UKDB

Institutionalised vs. grouped/co-ordinated activities

How might rules on state subsidies apply (need to break even such as ECGD) and how does it relate to the UK International Development Act

Would loans be counted as ODA, would the amount leveraged in on the capital markets be counted as ODA, what would be the effect on the government budget, and what are impacts on distribution of ODA over time? (see figure 4)

How would a UKDB co-operate with

Other UK financing institutions in the UK (a planned infrastructure development bank)

Other UK public financing institutions operating in developing countries (CDC, ECGD; e.g. KfW is parent of DEG)

Non-UK public institutions in other countries (EIB, etc)

Other: Philanthropists, “impact” investors, commercial banks

The broad criteria to assess suitability of new financial instruments

Would the new instruments be more effective in fostering growth, reducing poverty and addressing global public goods?

Is there a demand for the instruments provided by a UK development bank?
What is the benefit of doing this via a new UK institution / entity as opposed to an existing institution/entity in UK or elsewhere?

How does it relate to existing (UK) government objectives, obligations and laws?

**Figure 4 How can ODA be managed when providing grants and loans**

- **Grants and concessional loans**
  1. Start giving loans, then receive repayments
  2. Few loan repayments in bad times but lots in good times

- **Grants only**
Annex 3: The Committee’s visit to Washington DC and Brazil

The International Development Committee visited Washington DC, Brasilia and Rio de Janeiro from 4–12 September 2013. The Committee members participating in the visit were Rt Hon Sir Malcolm Bruce (Chair), Hugh Bayley, Fiona Bruce, Richard Burden, Fabian Hamilton and Michael McCann. They were accompanied by Judy Goodall (Inquiry Manager) and Anita Fuki (Senior Committee Assistant).

In Washington, the Committee met representatives from the World Bank Group; the IMF; the Millennium Challenge Corporation; US AID; the Center for Global Development and other research organisations; and the Inter-American Development Bank.

The purpose of the visit to Brazil was to learn about Brazil’s experience during its recent period of rapid economic growth and poverty reduction; to hear about Brazil’s role in the international development world; and to discuss the potential for future trilateral development cooperation. In Brasilia, the Committee met representatives from the World Food Programme; the Inter-American Development Bank; Embrapa; the Brazil Agency of Cooperation; the Ministry of Environment; the Ministry of Social Development; and the Department of Women of the Chamber of Deputies. In Rio de Janeiro the Committee visited several transport and community facilities and had meetings with representatives of the Rio State Government; and BNDES (the Brazilian development bank). The Committee was accompanied in Brazil by members of the DFID Brazil office.

Brazil began a period of significant reforms to social security and assistance transfers during the mid-1990s, at a time of economic stability, trade reform and privatisation of some state-owned enterprises. Prior to the reforms, Brazil had a high level of inequality, with a low share of the gains from its growth going to the poor. An important part of its strategy to reduce poverty was through redistribution, with a number of conditional cash transfer programmes, several of which were merged into the ‘Bolsa Familia’ which grew to cover 11 million families or a quarter of the population. It was targeted at poor families and was conditional on their children staying in school and obtaining basic health care. The success of this programme and other social assistance spending, together with greatly reduced levels of inflation, led to a significant reduction in the proportion of extreme poverty in the Brazilian population (from 17% in 1981 to 8% in 2005).194

In Brasilia, some of the Committee members visited the Embrapa Genetic Resources and Biotechnology Research Centre and heard how Brazil’s investment in agricultural research has led to significantly increased food production. Before the 1970s, Brazil was not a food secure country, but better understanding of tropical agriculture, better agricultural policies, improved institutional building and market knowledge and better developed infrastructure (such as roads and storage facilities) have led to increased land use for agriculture and increased yields. The Brazilian savannah is similar to some parts of the African landscape, which means that, whilst other conditions might differ, some of this learning could usefully inform development in other countries. There are now some major joint projects, for example in Kenya, Uganda, Ethiopia, Ghana and Tanzania. Embrapa is innovating in knowledge exchange, South-South cooperation and investments related to the achievement

194 World Bank Group, A comparative perspective on poverty reduction in Brazil, China and India, 2011, Martin Ravaillon
of the MDGs. Embrapa and DFID both contribute to the Agricultural Innovation MKTPlace, an international initiative supported by different donors which links Brazilian, African and Latin American and Caribbean experts and institutions, and develops cooperative projects for the benefit of smallholder producers.

The Committee met representatives of the World Food Programme, and were told that 47 million children in Brazil receive healthy school meals under Brazil’s school feeding programme. The World Food Programme requested Brazil’s help in creating a centre of excellence to help establish other national programmes. 23 countries have been involved to date, with the main focus being in Africa, but also Bangladesh, East Timor and a few other Asian countries. DFID is involved with helping visiting countries learn from Brazil’s programme, and developing their own programmes. The Committee was told that DFID was valued for its humanitarian and international cooperation expertise, which helps ensure that Brazil’s knowledge is transferred more effectively to Africa.

In Rio de Janeiro, the Committee saw some of the several different aspects of the city’s integrated poverty reduction programme. This included the new railway control centre; the cable car system which connects residents living in the poorer areas of the city to the more affluent areas with more job prospects; one of the Pacifying Police Communities centres which were installed in territories previously controlled by armed drugs gangs; a local health centre and a local school. The Committee also visited a community to see some of the recent improvements in infrastructure and services, and heard from Rio State Government officials about education, housing and health policies. Officials told the Committee that DFID’s assistance with the detailed evaluation of these new policies and projects would be particularly welcome, as well as support in transferring successful learning to developing countries.
Conclusions and recommendations

1. We were surprised to see a huge fall in the percentage of UK bilateral ODA spending on Low Income Countries. We note DFID’s explanation that the main reason is the graduation of countries to middle income status. Nevertheless, we recommend that DFID maintain spending on Low Income Countries as its priority. We further recommend that DFID review its programmes in all MICs to examine the scope for reallocating bilateral aid from MICs to LICs and to set a timetable for doing so. (Paragraph 7)

2. There has been huge progress in developing countries. The number of people living in extreme poverty since 1990 has halved, and the prospect of ending extreme poverty by 2030 is within reach. Aid is still of critical importance, especially for reaching the very poorest people in Low Income Countries and we believe that they should remain the priority for UK aid. Aid programmes can help to build mutually beneficial trade and economic cooperation relationships with emerging economies and we believe that a stronger emphasis on economic development can be fully consistent with poverty reduction. As a first step, we recommend that DFID work with the OECD DAC to review, update and clarify the ODA definitions. (Paragraph 18)

3. Members of the Committee, during visits to developing countries, have observed repeatedly the enormous inequalities in income, health, education and life prospects for the people in developing countries compared to those in richer countries like the UK and, frequently also, the gross inequality between richer and poorer people within developing countries. The High Level Panel drew attention to the continuing challenge of addressing inequality and rightly emphasises the maxim “Leave No One Behind”. We recommend that DFID should set out in its response to this report what steps it intends to take to assist in the reduction of inequality globally and within the developing countries in which it has bilateral programmes. (Paragraph 19)

4. We recommend that, in general, Middle Income Countries should graduate from aid, but in a controlled manner which takes account of needs and resources. During the transition period, we recommend that aid programmes make more use of technical assistance, support to NGOs, and loans, as discussed later in this Report. Meeting the needs of the poorest in Low Income Countries should remain our priority, but supporting transition in Middle Income Countries, and financing global public goods all make the case for significant development finance. We plan to hold a separate inquiry in the future into climate finance. We fully support the international commitment to the 0.7% aid target and believe that it should be maintained. (Paragraph 20)

5. In this connection, we welcome the Secretary of State’s initiative of conducting a review into how DFID should respond to the changes in the development landscape. We recommend that this should include the publication of a development finance strategy for the coming decade, setting out DFID’s analysis of the issues to which it must respond, the pros and cons of different options, its preferred approach and the reasons
for those choices. It should include an assessment of the following issues: (Paragraph 21)

- The function of aid, should it remain focused on poverty reduction and economic growth, but in the longer term should it also include international cooperation on global public goods if so, what are the implications of this for both future funding requirements and cooperation with other Government Departments?

- Climate finance, which requires much more serious analysis, including the extent to which aid is used to fund climate related projects and which countries should be eligible for aid to fund such projects.

- The OECD definition of ODA; how DFID will work with the OECD review to ensure that the focus remains on addressing poverty? We believe that DFID should make a statement about its proposals for change in the definition before the Summer Recess 2014 to give Parliament and civil society the opportunity to comment on the Government’s objectives before the OECD finalises any changes at the meeting of OECD Ministers in December.

- Whom is aid for: just for low income countries, or for people in poverty wherever they live? Whether the existing definitions of low, middle and high income countries are still useful or whether there are better ways of defining priority countries and identifying financing gaps? Should aid be targeted at extreme poverty, or at other levels of poverty as well, or at countries with large financing gaps and weak prospects for economic growth? How can aid help to reduce inequality when average incomes are rising but poverty levels are not reducing?

- The thresholds for defining Middle Income Countries needs to be reviewed and updated. We urge DFID to encourage the World Bank to examine them.

- DFID’s strategy for aid to middle income countries: how will DFID identify and respond to the continuing development needs of these countries? What criteria will it use to withdraw aid from countries as they transition, and how will it decide to start different types of relationships based on different instruments?

- The contribution of DFID and its financial mechanisms towards addressing inequality, equalising opportunities and ensuring that no one is left behind.

6. We are disappointed that neither Germany nor France appear to have backed up their stated commitments to achieve the 0.7% GNI aid target by 2015 with the necessary allocations in their forward budgets. (Paragraph 35)

7. The growth in sources and types of development finance mean that developing countries now have more choice and can in some cases elect to opt for finance which is delivered more quickly and with less conditionality than traditional aid. However, aid is still of critical importance, especially for reaching the very poorest people, for leveraging in other resources and for helping growth in low income countries. For some other major national donors, such as Japan, Germany and France, concessional loans represent a significant part of their bilateral aid delivery. DFID must continue to evolve its strategy so that it continues to target its resources in the most effective
way, including providing a combination of grant aid, loans and guarantees. (Paragraph 38)

8. Development aid in the form of grants is very limited and precious and it is getting increasingly difficult to make the case for giving aid in the form of grants to MICs. We believe that DFID should also develop the capacity to distribute aid in the form of concessional and non-concessional loans either “in house” or by establishing a UK development bank. We recognise that it is will take time to build the capacity to manage loan finance but the expectation, once the capacity has been established, should be that grants to MICs should only be used where no other form of finance is possible. There may also be circumstances where loan finance would be appropriate in low income countries, for example to finance infrastructure, such as power generation, which will generate a return on investment, but care should be taken not to re-burden least developed countries with unmanageable debt. We believe that grants should continue to be used for financing access to basic minimum needs in LICs like health, education, sanitation and water and where speed is of the essence, for example for emergency relief; for failed states and major conflict areas; and for global public goods which cannot be funded in other ways. (Paragraph 39)

9. There are many large public sector projects in the developing world which require finance. Concessional loans are one way of supporting such projects which have potential economic benefits for developing countries. They can offer benefits to donors in terms of recycling finance and leveraging additional finance; and to recipients in terms of offering a less expensive option to market loans. For concessional loans to be effective, donors need to have the appropriate skills and expertise to ensure that loan finance works properly and is used appropriately, so that projects are fully implemented and achieve the desired development impact; that the debt sustainability of the recipient country is not threatened; and that the loan is repaid. (Paragraph 47)

10. The Secretary of State told us that DFID would continue to provide concessional loans where necessary through multilaterals, but that it had no immediate plans to start offering bilateral concessional loans. She also said that DFID might consider providing bilateral loans on a case by case basis. This ambiguity could be confusing. (Paragraph 48)

11. We believe that there is a strong case for providing concessional loans, especially to lower Middle Income Countries. For example, DFID is working with the Indian Government on a programme to support the transition from a grant aid based relationship to one of mutual cooperation on trade and economic development. We believe that DFID should consider the scope for providing loans to regional governments within India as part of this transition programme, in order to support public sector projects in those regions which continue to have high levels of extreme poverty. This could provide a model for the transition arrangements for other middle income countries. (Paragraph 49)

12. We recommend that DFID sets out criteria which it can use to judge whether it still has the most appropriate multilateral and bilateral instruments. Given the rapidly changing context, it should actively consider introducing new finance instruments, or it
will risk reducing its effectiveness. We recommend that DFID includes an assessment of the following issues in its finance strategy: (Paragraph 50)

- Is there a demand for bilateral concessional loans for public sector projects, and if so, from which countries and sectors?
- What additional skills and expertise would DFID need to provide and manage bilateral loans? What additional processes would it need to introduce?
- What are the relative merits of providing loans through multilaterals, and bilaterally? In what circumstances and for what projects would DFID consider providing bilateral loans?

13. It is important to be clear where public money (ODA) is likely to strengthen the private sector and where it risks compromising the useful free play of market forces. DFID has provided effective support for the private sector (establishing land registries, strengthening support for SMEs, capital markets, trade facilitation etc). However, there are potential dangers, notably in creating non-competitive businesses through public funding. (Paragraph 60)

14. Supporting the private sector can have significant benefits in terms of boosting economic growth, creating jobs and raising incomes in developing countries and helping to deliver projects with other social benefits. Finance provided as returnable capital could potentially play a greater future role, and enable the finance which has helped businesses to become sustainable and profitable, to be reinvested in other projects. We think that there is significant scope for support to the private sector, but as such projects are expected to make a return, we recommend that when DFID is dealing with the private sector, the presumption should be that finance will be provided as returnable capital. (Paragraph 67)

15. We welcome the launch of the Impact Investment Fund and ask DFID to supply further details of the role and operation of this fund, including details of whether finance will be provided as grants or loans or other instruments. (Paragraph 68)

16. We recommend that private sector support should be an integral part of DFID’s finance strategy, and that support for the private sector could be scaled up. We recognise that this will require new skills. We recommend that DFID’s finance strategy includes an assessment of the following factors: (Paragraph 69)

- How can DFID target its private sector support such that it supports inclusive growth?
- How can DFID assess and measure the development impact of its private sector support so as to take account of broader outcomes such as improved livelihoods, income growth and leverage, as well as jobs created?
- Should the remit of CDC be extended? Have the recent CDC organisational changes increased its development impact? Would bringing CDC under more direct DFID control improve DFID’s development impact?
• Can the success of PIDG be further extended or replicated for other countries and sectors?

We propose in a future inquiry to look at DFID’s private sector work.

17. In addition, the creation of a new UK institution with the capacity to provide a range of bilateral finance instruments and technical assistance and the ability to work in partnership with other development banks and multilaterals could enable it to deliver a range of longer term support to build on its humanitarian and rapid response to emergencies, such as that to Typhoon Haiyan in the Philippines. The Philippines is a lower middle income country with which the UK has no bilateral aid programme. It will need substantial investment to enable it to rebuild essential infrastructure and services. DFID has promised to assist in the reconstruction of the Philippines; the technical assistance, guarantees and loan finance which will be needed might best be delivered through a development bank. (Paragraph 74)

18. The UK is unusual in the G20 in not having its own development bank. Establishing a UK development bank could give the DFID bilateral programme a way of providing a wider range of finance instruments, to complement its grant aided programmes which we would expect to continue for the poorest countries. A UK development bank could offer a range of new instruments, including concessional loans, together with technical expertise which is often valued as much as finance. However, there is a real danger that establishing a new UK development agency outside DFID would fragment UK development policy. Great care would need to be taken to avoid this danger and to ensure that a new development bank would work closely with existing institutions. (Paragraph 81)

19. We recognise that establishing a new UK development bank would be a major undertaking, which would need careful planning and a measured implementation, but believe that DFID should plan for the long term. Creating new institutions is challenging but not impossible; for example the Government has created the Green Investment Bank in less than three years. The ‘do nothing now’ option carries the risk that DFID’s bilateral approach becomes less effective over time and that it is unable to play a key role in the future. (Paragraph 82)

20. We recommend that DFID establish a financial instrument team that can prepare a development finance strategy; coordinate the various finance initiatives that are currently being piloted by DFID; draw together the different bilateral and multilateral approaches; design new instruments and build up the necessary skills for future innovation and development. Without this effort, DFID may not be in a position to establish a development bank if and when it were deemed advantageous to do so. (Paragraph 83)

21. We recommend that DFID considers the following questions in its finance strategy: (Paragraph 84)

• What are the development financing gaps in terms of instruments, sectors and countries? What niche could a new UK development bank fill? Would the new instruments be more effective in terms of fostering growth, reducing poverty and addressing global public goods?
What would be the potential advantages and disadvantages of establishing a UK development bank? What could be achieved, or achieved better, through a new UK development bank compared to existing institutions? What comparative advantages would a UK development bank have over existing institutions?

What are the pros and cons of other alternatives, including no change; developing closer working arrangements with multilaterals; providing concessional loans through the existing DFID structure; and expanding the scope of CDC?

How would a UK development bank cooperate with other UK finance institutions and other development finance institutions?

What are the institutional and legal issues which would need to be addressed?

What would be the costs and possible timetable for establishing a UK development bank?

What new skills would DFID need to acquire and how would it do so?

What is the potential role of new finance instruments, such as Development Impact Bonds and Diaspora Bonds?

One option open to DFID would be to channel more of its finance through multilaterals, and to make use of their wide range of specialist skills and expertise, rather than attempt to replicate all of these in its bilateral programmes. In order to determine the appropriate balance of bilateral and multilateral spending, DFID must be able to compare the relative outcomes and value for money of these different channels, both in countries where it has a bilateral presence and those where it does not. *We reiterate the recommendation that we made in our recent report on the Multilateral Aid Review, that DFID develop mechanisms for comparing the relative effectiveness of bilateral and multilateral aid.* (Paragraph 88)

Whilst we recognize the strengths of multilaterals in some areas, we firmly believe that DFID must continue to maintain a strong bilateral presence in order to maintain the UK’s influence in individual countries, and to monitor the performance of multilaterals which the UK finances. DFID must also maintain sufficient influence within multilaterals in order to monitor and influence their spending priorities. *We recommend that DFID explore the potential for embedding more DFID staff within key multilaterals, and for increasing the opportunities for sharing learning and experience with its partners.* (Paragraph 89)

We welcome DFID’s work on promoting South-South cooperation, as a complement to development finance efforts. Emerging economies, such as Brazil, have much to contribute to developing countries. *DFID has only a limited presence in Latin America, and we recommend that it explores the potential for small DFID teams to work closely with multilaterals on specific projects, so as to benefit from their specialist knowledge and to contribute to its learning from emerging economies. We recommend that DFID establish an innovation and knowledge transfer unit which would be responsible for identifying good development practice and transferring relevant knowledge and experience to other projects and country programmes. We would expect*
the unit to be based in the UK, but to have sufficient capacity to deploy a few people to participate in and learn from country programmes, and to cooperate with the FCO where necessary. We also recommend that DFID explore ways of helping low income countries to share their knowledge and experience with each other. (Paragraph 93)

25. An increasing number of people living in poverty are in Middle Income Countries, which should eventually graduate from traditional grant aid. Donors are likely to combine grant aid to the poorest countries with new forms of engagement in Middle Income Countries, including technical assistance, support to NGOs and loans. They will want to invest more in supporting South-South cooperation and they are also likely to spend more resources on global public goods. If DFID is to retain a leading role in this changing development world, and maintain its relevance, it will need to innovate in its use of development finance. DFID will need to think carefully about the balance between bilateral and multilateral aid, and about how to deploy new forms of finance. (Paragraph 94)

26. DFID needs to have a more explicit overall strategy on what financial instruments to use when, how much in each case, to which countries, via which channels, under what circumstances, and what skills are required to use them effectively. It also needs to address how the UK can remain relevant for developing country needs, how it can remain an innovator in the provision of aid, what UK aid will look like over the coming decade, and its strategy for getting there. In particular, DFID will need to think carefully about whether and how to provide bilateral loans to developing countries. This will not be a process that can be done quickly, and will require a different set of skills. DFID will also need to consider the mechanisms which would be required for providing bilateral loans, including whether and under what conditions a development bank would be required. To do this effectively, we recommend that DFID develops a comprehensive statement and development finance strategy to define its future role and how it will be financed. This should take the form of a Development Finance White paper, to be published during 2014, which should, inter-alia, set out the contribution of DFID and its financial mechanisms can make towards addressing inequality, equalising opportunities so as to "Leave No One Behind", as advocated by the High Level Panel. (Paragraph 95)
Formal Minutes

Wednesday 5 February 2014

Members present:

Sir Malcolm Bruce, in the Chair

Hugh Bayley
Fiona Bruce
Fabian Hamilton
Pauline Latham

Jeremy Lefroy
Michael McCann
Fiona O’Donnell

Draft Report (The Future of UK Development Co-operation Phase 1: Development Finance), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 95 read and agreed to.

Annexes and Summary agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report (in addition to that ordered to be reported for publishing on 11 and 18 June, 9 and 16 July, 3 September, and 9 and 22 October 2013.

[Adjourned till Tuesday 11 February at 9.30 am]
Witnesses

Tuesday 18 June 2013
Jonathan Glennie, Research Fellow, Overseas Development Institute,
Elizabeth Stuart, Director of Policy and Research, Save the Children, and
Richard Manning, Chair of Board of Trustees, Institute of Development Studies
Ev 1

Peter Chowla, Co-ordinator, Bretton Woods Project, Matthew Martin,
Director, Development Finance International, and Professor Stephany
Griffith-Jones, Columbia University
Ev 12

Tuesday 2 July 2013
Owen Barder, Senior Fellow and Director for Europe, Centre for Global Development,
Andrew Rogerson, Senior Research Associate, Overseas Development Institute, and Peter Young, Director, Adam Smith International
Ev 23

Tamsyn Barton, Director General, European Investment Bank, Marc Engelhardt, Director of Development and Climate, KfW Development Bank,
Dorothee Fiedler, Deputy Director General, German Federal Ministry for Economic Co-operation and Development, and Dr Chris West, Director, Shell Foundation
Ev 35

Tuesday 3 September 2013
Simon Howarth, Technical Director, Mott MacDonald, Philip Schluter,
Managing Director, Schluter Ltd, and Caroline Ashley, Director, Ashley Insight Ltd
Ev 46

Diana Noble, Chief Executive Officer, CDC, Holger Rothenbusch, Managing Director, CDC, and Edward Farquharson, Executive Director, PIDG Programme Management Unit
Ev 54

Wednesday 9 October 2013
Rt Hon Justine Greening MP, Secretary of State for International Development, Susanna Moorehead, Director, West and Southern Africa, Department for International Development, and Professor Stefan Dercon, Chief Economist, DFID
Ev 66
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(published in Volume II on the Committee’s website [www.parliament.uk/indcom](http://www.parliament.uk/indcom))

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Oral evidence

Taken before the International Development Committee
on Tuesday 18 June 2013

Members present:
Rt Hon Sir Malcolm Bruce (Chair)
Hugh Bayley
Fiona Bruce
Richard Burden
Fabian Hamilton
Pauline Latham
Jeremy Lefroy
Mr Michael McCann
Chris White

Examination of Witnesses

Witnesses: Jonathan Glennie, Research Fellow, Overseas Development Institute, Elizabeth Stuart, Director of Policy and Research, Save the Children, and Richard Manning, Chair of Board of Trustees, Institute of Development Studies, gave evidence.

Q1 Chair: Can I thank you all for coming in to help? This is the first evidence session we are taking on a fairly longish inquiry, looking at the future of development co-operation. For the record, could you introduce yourselves?
Richard Manning: I am Richard Manning. Is that what you want me to say?
Chair: Well—just your title, as it were.
Richard Manning: I am an independent consultant and chair of a couple of boards, and I am currently co-ordinating the replenishments of the African Development Fund and the Global Fund.
Elizabeth Stuart: I am Elizabeth Stuart, director of policy and research at Save the Children.
Jonathan Glennie: Good morning, Jonathan Glennie; I am a research fellow at the Overseas Development Institute, working on aid and development finance.

Q2 Chair: Thank you very much for coming in. Obviously, the whole development landscape is changing. DFID has acknowledged that in their evidence to us. I suppose the preface is that we have been very focused on delivering 0.7%, which hopefully we will achieve, and we are committed to achieving, this year. However, it is really quite important to say, “0.7% to do what, and how will it change over the next 10 to 15 years?” DFID say the development finance landscape has changed rapidly over the last decade and is likely to continue to do so. I wondered if you could give us your views on what you think have been the key things that have been driving this change, and what the implications are for DFID, because obviously that is what is of concern to us.

Is DFID in its present structure and format fit for purpose? Is it appropriately deployed for the future, or does it need to reorganise itself in any way to meet these changes? That is essentially what we would like to set the course to hear. Who would like to kick off?
Elizabeth Stuart: I am happy to start. You are absolutely correct; I think everyone would agree that the landscape is changing. The main differences on this new global horizon would be the rise of Middle Income Countries and BRICs, and with that the new location of the poorest. Andy Sumner’s work identified that 72% of poor people now live in Middle Income Countries, not because they have moved but because those countries have changed status. Twenty-eight countries have graduated from Low Income Country to Middle Income Country over the past decade, which is a huge change. Some of those countries have now become donors themselves, in some cases at the same time as being aid recipients. There is also the introduction to the aid landscape of large-scale lending by philanthropic foundations, NGOs and the private sector. Some of that is not new, but the scale of it is new. We have not seen this kind of scale of lending before. It is difficult to quantify exactly the amount of aid coming from non-traditional, non-DAC donors, but it seems to be substantial. One calculation, by Homi Kharas at the Brookings Institution, has assessed that, if you take what is called country programme aid, which is aid that is delivered to the country for the country to spend in-country—so it is not being spent on domestic consultants or things like that—then aid from non-donors is of the same size as aid from traditional donors, which is fairly extraordinary.

Briefly, the implications on this for DFID would first of all be the amount. We would argue very strongly that, in the short to medium term, the 0.7% figure is absolutely still necessary. It has been very carefully costed. Back in 2005, the UN estimated that to meet basic poverty needs—i.e. to reduce basic poverty and nothing but that—donors would need to be spending 0.54% of GNI. However, if you wanted to get to the wider sorts of poverties and the wider inequalities, which indeed DFID does and which we would very much welcome because it is not just about income, you would need to be spending approximately 0.7%. It has been very carefully costed, and it also seems clear that, although poverty is actually reducing—we have seen the extraordinary poverty reduction figures in countries, primarily led by China but in other countries as well—counter-intuitively reducing poverty is going to get more expensive because the people who are left in poverty are the hardest to reach. You might like to term it “the highest hanging fruit”. The people who have been reached so far are those who are easiest to bring to above an internationally
agreed poverty line. The people who are left in poverty are going to be the hardest to reach; it is going to be more expensive. Also, if we are going to be more ambitious in what we are trying to achieve with our poverty reduction, which is very much the parameter that has been set out in the process that is being co-chaired by the Prime Minister around a successor to the MDGs, the post-2015 process, what is being targeted is something that is rightly a bit broad and ambitious. The 0.7% figure needs to stay in the short to medium term. Of course, we do not want to be aid-dependent forever, but in the long run, as John Maynard Keynes said, we are all dead, so I think in the short to medium term, it needs to be there. There are other implications for DFID. It will not be a surprise to you that we are very supportive of UK aid; we think it is very high-quality and effective. We like the emphasis on fragile states. Again, according to the work done by Andy Sumner, two-thirds of the poorest people are going to be living in fragile states, so that emphasis by DFID is very welcome.

There will need to be a greater emphasis on partnership, though, particularly with Middle Income Countries. Relating to Middle Income Countries will not be a traditional relationship of donor/donee; it needs to be more of a partnership. There needs to be a greater understanding of soft skills at DFID rather than the traditional managing big aid programmes. Finally, we do think that Middle Income Countries should still be receiving aid, but I can talk about that later.

Chair: We will explore some of those in a bit more detail.

Richard Manning: I agree with what everybody has said about the changing landscape. I do not have anything very new to say about that. I suppose the question is how we can achieve sustainable improvements in people’s lives as the world population grows to about 9 billion people in 2050.

We are on a path to somewhere we have not been before. Admittedly, populations are growing more slowly, but this is a big challenge. Sustaining these people on a gradually improving level of income is a huge challenge for everybody. It seems likely that, given the very large disparity that still exists between incomes in different countries, some form of inter-country concessional flows from the official sector is going to be a very important part of achieving a sustainable future for all of us. There is still a case for a strong investment by countries in these cross-border official concessional flows.

Obviously, you have to position this in a world where we are dealing with the results of huge progress. I used to deal with Bangladesh when I was working for DFID’s predecessor in the late 1970s. The figures show that, in those days, aid was more or less equivalent to total tax revenue in Bangladesh. Tax revenue in Bangladesh is now six times aid flows to Bangladesh, not because aid flows have fallen but because tax revenues have hugely increased. Ghana, a country which was desperately marginalised in the 1980s, famously launched a Eurobond in 2008. Other poor African countries, many of them recipients of debt cancellation and HIPC, have been doing the same in the recent past, so we are definitely in a different world. To me, a crucial issue is the proper use of these funds and whether we have a good system internationally for encouraging debt-creating flows to be used in a sustainable manner. That is a very important issue.

Finally, on DFID, I obviously have a bias as I spent most of my life working for DFID and its various predecessors from 1965 to 2003. There are many models of how you deliver aid across countries. When I was also chair of the OECD Development Assistance Committee, we produced a publication, which I recommend to the Committee, about the characteristics of more or less effective official aid systems. It is not about one model being inherently better than another. The Dutch have a totally different model from the British, but both have proved to be quite effective.

DFID does tick a lot of the boxes. It has got a strong legal basis and a budget that can be very flexibly used across different types of assistance. The multilateral and bilateral trade-offs can be done more easily in that kind of system than one where the Ministry of Finance does or the IFIs, and the Foreign Ministry does other forms of assistance and so on, which is the case in many other countries. Also, and this is a key strength of the British system that one would perceive internationally, DFID has over the years built a fairly high level of core expertise, and managed to combine professionals of various kinds into one entity with a single focus. That is quite a powerful model, in my opinion.

As far as 0.7% itself is concerned, everybody knows the history of this and it would be unlikely that there is a magic about this figure. It is curious to have a target for inputs, i.e. spending, rather than for outcomes such as the Millennium Development Goals or whatever framework we have after 2015. I think the argument that has been used, however, right from the start of creating the concept of official development assistance in the 1960s, is that there is some value in an international norm that incentivises countries to move in a particular direction, particularly for a category of spending that is not self-evidently in their very short-term interests. This is long term.

Chair: We are going to come back to that in a bit more detail later.

Jonathan Glennie: Of the changes that are taking place, for me there are two mega changes that are irreversible; the rise of the poorer countries, the emerging countries as now described, has transformed the global landscape in every way, and we are talking about development as a subset of that; and secondly, and this has been going on for decades but, again, is about to be part of the UN framework finally, the sustainable development aspect—the recognition that we are living within planetary boundaries. Those are the two new elements in this era of development. There is a third, which may not be irreversible, which is the realisation that the experiment with exaggerated neo-liberalism over the last 30 years was a mistake. In other words, there is a recognition that too much focus on the private sector and neglect of the public sector was a mistake, and there is a rowing back from that.
I have a couple of comments on the changes in poverty. There is an opportunity for the Committee in looking at the next steps for DFID over the next two to five years, or however long your time horizon is, also to set out the beginnings of a transformation of our understanding of poverty and the role of aid. We and Andy Sumner’s numbers think of poverty as $1 or $2 a day. It is an incredibly stingy analysis of poverty. There are even some analyses going round today that people living on $10 a day should be described as middle class.

Our traditional understanding of people living in poverty is an incredibly stingy one. We need to be thinking about bringing people up to something approaching the standard of living that we have in this country. If we start thinking that way, we are miles away, and years and decades away, from resolving some of the problems that exist in our world. We have to be careful of combining this idea that of course you want to end extreme poverty in the poorest of the poor with the idea that, at that point, our responsibility as wealthy countries begins to come to an end, which is often what one hears in the press and in some analyses at the moment. That is a big mistake.

Secondly, as we know, the definition of a Middle Income Country is when countries have an income per capita of $1,000 a year. That is totally arbitrary; we do not even know where that equation emerges from—somewhere in the 1960s or 1970s in the World Bank. There is a danger of focusing on Middle Income as a level. We need to start thinking about the role that aid plays. We have Andy Sumner’s numbers. I know Andy, and he has done some really important work. Nevertheless, the supposed move of poor people to Middle Income Countries I think is quite misleading. It is basically talking about five countries. Yes, a lot of countries have moved to Middle Income status in the last 10 years. It is worth noting that, in the ’80s and ’90s, there was also a great movement towards Middle Income, and a lot of countries regressed again. Let’s not assume that this is uni-linear. Things can happen; shocks can happen. In the late ’90s, shocks did happen. Countries that were Middle Income moved back to low income status. This movement of poor people to Middle Income is based on five countries: China in the late 1990s, while India, Pakistan, Indonesia and Nigeria all became Middle Income Countries in the last 10 years. Some 80% of the poorest people in the world live in 10 countries. When those countries shift over an arbitrary barrier, they have suddenly become Middle Income. That really does not mean anything, in my view, in terms of what the role of aid is in those countries. If you look at countries like India, they have been receiving a very small amount of their GDP in aid for the last 20 or 30 years; I think it is 0.2%. That money has never been significant. The question becomes: what role does that money play? I worked in Latin America for a long time, and those countries are not aid-dependent and really never have been, certainly not for decades. Again, what is the role of aid? It is a very small amount of money in Middle Income Countries and those countries that do not depend on aid, compared with the role of aid in countries that are heavily dependent on aid, most of which are in Africa—and they are increasingly less dependent on aid as well.

The final thought I will share with you is on the rise, as Liz mentioned, of aid from other countries. It is quite an interesting position that we are in—that in traditionally wealthy countries, we are re-examining the purpose of aid. I know there is quite a strong pressure on MPs and others to look at why we still need aid in this world. When you look around the world, countries are setting up aid agencies, which is quite the reverse of what is happening here. They are just beginning on the process of engaging in aid. That is because, as we know, the term “aid” is a little bit unhelpful because it is has got history. Most countries setting up aid agencies do not call it aid.

Chair: Well, this is the International Development Committee, and we like to call ourselves that.

Jonathan Glennie: Sure, but it is International Development. I have no problem with using the word “aid”—it does not matter—but what I am saying is that most countries that are setting up international development agencies do not call it aid; they call it co-operation. There is a very strong recognition that this is about mutual benefit between countries. The idea that it is from rich to poor is happily beginning to be less important. It is still important, of course, in the transfer of wealth, but now it is much more about interchange of experience, ideas and, yes, money when it is necessary.

I can see a future in which rich countries no longer deliver money to poor countries but all countries in the world, including the very poorest countries, contribute a certain amount of their income to respond to the global challenges that exist. Those would be basically the Global Public Goods Agenda. That is the long-term vision that I would use to challenge the idea that aid is somehow on its way out.

Chair: I can see Fiona Bruce has a question.

Q3 Fiona Bruce: Yes. Elizabeth, you said we need to be more ambitious. For example in education, how practically could you make this happen? We have had a massive investment in primary education, but we now see, for example, in Africa, the growth of jobless young people under the age of 25. We have got to invest in science and technology and change our whole approach towards education and our focus. How do we broaden our approach to that investment? Isn’t it essential that we also do that with businesses and with industries as they invest in those nations? In other words, that is what Jonathan is talking about, which is co-operation.

Chair: That was focused at Jonathan. I think.

Fiona Bruce: Elizabeth first, I think, because it is how we have to think beyond the box now. All these young people are coming out of school at 12 or 14, but what do they do?

Elizabeth Stuart: Absolutely. That is right. Getting children into school is the first stage. Getting children out of primary school able to read, write, and do arithmetic—basic educational attainment—is the next stage. Getting them into secondary school is the next stage. Then thinking about tertiary education, skills and vocational education are all absolutely vital. I go back to the money question: there still is not enough...
money to do the first thing. That does not mean we should not be ambitious and trying to achieve two, three, four and five down the line, but we need to be realistic that number one has not yet been attained. We have made huge strides, but it has not yet been attained. We are getting better, in that we are looking at measuring impacts and not looking at inputs. I take the point about money being an input, of course, but our interest is in the outcomes. We need to get better at examining what developmental outcomes we want and being able to measure those. We need to get better data to be able to do that as well. Then I think we need to be very clear that the private sector does have a major role to play in terms of building skills, and not least in terms of creating jobs. That said, there is a slight caveat on that; it has got to be the right sorts of jobs.

Save the Children just signed a partnership agreement with GlaxoSmithKline, for instance. We are interested in innovative ways of working with the private sector, but we have to make sure that we are very clear on what the private sector is, because it is many different things in different countries. The private sector can be a kiosk in an unpaved street that is selling de-worming tablets as malaria pills, or it can be a multinational company. What has been lacking in the past has been exactly that: the evidence. The impact that private-sector investment has had on poverty reduction has not been looked for. Analysing and measuring those impacts is very important. When polling is done of poor people in poor countries, and when the World Bank carried out the Voices of the Poor exercise, a key ask that poor people have is they want jobs.

**Fiona Bruce:** Yes, absolutely.

**Elizabeth Stuart:** I think Nancy Birdsall from the Centre for Global Development put it very nicely, I heard her speak the other day in London, and she said, “It is about pay stubs rather than about entrepreneurship.” On the whole, it is about a regular pay check.

**Q4 Fiona Bruce:** I absolutely agree. A brief supplementary, if I may. We need to help countries, particularly emerging countries in Africa, to ensure that, if other countries are coming in and starting to build factories and develop and take advantage of—I do not mean that pejoratively—a work force, the benefits of that are suitably gained by the local indigenous population. We need to ensure that Governments are poised to create that kind of development, much as you would have a parallel here of a Section 106 agreement in a local community. Do you think there needs to be much more help given to Governments to do that?

**Elizabeth Stuart:** Yes, absolutely I do, but it is also about policy coherence here at home. It is about the role we play in negotiating trade deals in terms of the business environment that is being established in a country. It has also got to do with the sorts of norms we are looking for and favouring in our aid allocations, which is also to some extent, in some countries, continuing to drive domestic policymaking around the business environment. For instance, the World Bank Doing Business league tables have just been revised. However, they are still favouring very light-touch regulation, which is not necessarily going to be the kind of regulation that delivers decent work—as you said, the kind of work where the benefits can be captured by local communities.

**Q5 Richard Burden:** In your opening remarks, all of you have highlighted very well the huge agenda we are dealing with here. Responding to Jonathan, we are very clear that what we are trying to look at here is the future development co-operation, not simply the future of aid as defined by ODA. However, that is part of what we are looking at, and I would like to ask you all a little bit about that, in particular the Middle Income Country issue that you have all touched on. As far as ODA is concerned, and I think you will be asking in a while a bit more about definitions of overseas official development assistance in the future, how far do you think it should be focused on poverty in Middle Income Countries, or growth in Lower Income Countries, or more widely on global public goods, good in perhaps the sense of a much broader definition of what development assistance is?

**Jonathan Glennie:** I just want to reply very quickly to Fiona Bruce’s question. The international development community, insofar as there is one, focuses very much on specific aspects and sometimes neglects to realise the trade-offs that exist in developing countries that are political—there is a politics going on. Primary education is one of the classic examples. I was at the memorial of Meles Zenawi recently. He very famously rejected the idea that primary education should be the only focus of the money—or that it should be the primary priority, in fact. When countries try to transform themselves structurally rather than rely on outside finances, they need to invest in secondary and tertiary education. The current Director of the UN Millennium Campaign, Charles Abuagre, said that if he had only one goal out of the post-2015, it would be girls into secondary school. It is at secondary-school level that they start to transform their own villages. They get into jobs, and that is when society starts to change.

It is understandable why the international development community is focused on absolute poverty and the basic primary education. At the same time there are trade-offs, and we have to accept that. The same goes for the private sector. There has been a lot of focus on microfinance, and I strongly agree that we need to look much more at jobs than just growth, and much more at transforming local economies than just at microfinance.

On the question of Middle Income Countries, I very much take the way that you split that up. On the one hand, is there a role for the international community to support development in Middle Income Countries? I think the answer to that is quite clearly yes. Middle Income Countries are where the vast majority of the poor live. Apart from anything else, the vast majority of countries are Middle Income Countries. They are immensely important for security, climate and other
sustainability issues. Does the international community, led by the UN, need to work with Middle Income Countries to support their development? They are also in danger always of regressing when they have not got the institutional structures strongly defined, so yes.

The next question is how, and is there a role for development finance? What kind of development finance? ODA is a particular kind of development finance, but there are many others. As I said before, my view is that we need to understand much better the role that aid, international public money, has played in countries that have never received large amounts. In other words, for very aid-dependent countries in Africa the role of aid is incredibly different; it is half of the economy sometimes, whereas in countries like Colombia, where I was living, it is 0.1% of the economy.

The role that aid plays in Colombia could not be more different from the role it plays in Liberia, but that does not mean it is not important. If you look at the Paris Evaluation, the independent evaluation of aid in Colombia, just as an example—I know it is not a big focus for Britain—that catalytic money focused on human rights and supporting civil society. I worked for Christian Aid in Colombia. It is very difficult sometimes in very unequal societies, and India would be another example, to get money behind those parts of the society that are fighting for change, human rights and equality. Often that is international money, so we need to be very clear that it is not just a huge capital input to build infrastructure. It can be very catalytic money, and it may well be that over time it goes down.

Then there is the question of global public goods. No one that I have read has really got a very good answer to this yet. We all know there is a huge amount of money that needs to be spent. Development now, and this the big issue of planetary boundaries, is not just about development as we developed. It is a far more complicated task because it is development without screwing the planet up; it is green development. By most accounts, at the same time as hopefully giving benefits in the long term economically, in the short term that is going to be much more costly. Therefore countries need to be supported, and this is the basis of all the climate finance stuff, but it is quite an ambiguous area.

If we are saying we are reducing aid to India and South Africa and cutting aid to China, that makes perfect sense in our current understanding of aid. Yet with climate finance, we are quite clearly meant to be—and no one talks about it because you would probably find it very hard to sell to your constituents—increasing it to these very countries to help them grow sustainably. I think there is an ambiguity there. My view is that we need to do more thinking and research on it, but the answer is much more likely to be multilateral than bilateral. I suppose that is one message to DFID on that.

Q6 Richard Burden: The catalysing effect of aid was a theme that we developed in a number of reports, in the last Parliament in relation to assistance to China and, indeed, in this Parliament on the question of India. Could I just push you a little more? Part of that catalysing effect is spreading and generating best practice, and having a catalytic effect in that way. Another issue that you touched on was about combating inequality and spreading human rights. How far do you all feel that is a legitimate role for aid? Where do the limits of universal rights come up against national sovereignties?

Jonathan Glennie: I will come back to that with a very quick point, and I am sure Liz and Richard will also have comments, but there is no answer; it is incredibly complicated. Firstly, the international community has an absolute duty to focus on issues of inequality and human rights, which it does already. Again, though, it is more likely to be a multilateral than a bilateral response.

The attempts by DFID to use aid to improve human-rights situations in some of the aid recipient countries are unlikely to be successful in the long term. There is very little evidence; in fact, there is quite a lot of evidence that those kinds of conditions do not make long-term changes in highly complicated political societies. Nevertheless, the longer-term pressure from a range of agencies, multilateral attempts to focus on inequality and human rights, will make a change.

Women’s rights are an absolutely classic example. In most countries in the world, there is a strong focus on girls going to school. In some countries that is an indigenous movement, but in other countries a lot of that is down to international pressure and people sharing ideas. These things become internationalised.

Chair: Can I just point out that we are halfway through the evidence session and we are on the second question? We are going to need some snappier advice, and I know that Chris White is getting very agitated.

Q7 Chris White: It is getting late. There was just a very quick point in your wide sweep of international development. You mentioned the words “a trade-off”, and in that paragraph you mentioned a trade-off. Is there a trade-off between absolute poverty and secondary education, for example? How do you see that? Was that a casual remark, or is it one or the other?

Jonathan Glennie: Yes. I think there is a danger in international development. We see it as this kind of ideal, utopian way of working, whereas when you are working in politics in Britain, there are trade-offs the whole time. There are budgets to manage. The budget the current Government is managing is full of trade-offs.

Exactly the same is taking place in Ethiopia. There is a limited amount of money, so trade-offs have to be made. We will focus all our money on primary and neglect, to some extent, tertiary education, and what will that imply? Hopefully, that will mean having basic services for many more people, but possibly not the kind of indigenous Ethiopian engineers and scientists that we need to really move on from independence. Will we, and this is a hard thing to sell, say that there is a trade-off? Invest in universities and secondary, and possibly you will be slightly slower in achieving the primary education. Of course there are trade-offs.
Chris White: My view is that you have got yourself a little stuck in the horns of a dilemma. You can actually do both of these things. I do not think there has to be a trade-off between one and the other.

Q8 Hugh Bayley: Can I start with you, Richard, as a former chairman of the DAC? Do you think security and peacekeeping activities ought to be included within the definition of ODA?

Richard Manning: We did some work on this when I was chair of the DAC, and indeed we made a few rather small changes. There are arguments both ways about this. I think it is quite important if we are going to sustain this category. It always comes back to the question about definition. We have to be quite careful how far we broaden it. I think a lot of people would get off the train if it appeared to be covering military assistance and things that went to build military capacity and so on.

Q9 Hugh Bayley: Would you distinguish between police and military capacities?

Richard Manning: At the moment the DAC does, yes. The thing that does for police in developing countries counts as ODA; everything it does for the military does not. It is a very clear distinction.

The question is when the military is being used to do something. If you go to straight peacekeeping, the other thing you have to bear in mind is this is hugely expensive. I remember being involved with the Cambodian peacekeeping operation in the early 1990s, and the cost of the UN intervention was the same size as Cambodia’s GNP. The military are very expensive, so you would have to reconfigure a lot of things if you made a step of that sort. Some countries, including the Dutch, have clearly argued for this.

Q10 Hugh Bayley: We observed that point in South Sudan—the comparison between the UN peacekeeping costs and the GNI. What about other global public goods? We have talked a little bit about climate change. What about global public health, for instance?

Richard Manning: Of course a lot of this is counted already. If you take climate change, I do not know of any country that is not including at least all of its adaptation expenditure as ODA. We are trying to eradicate polio. That is no doubt all counting as ODA, but its benefit will include huge benefits to the national health service in saving money; that has been clear all along.

I think this comes back to Jonathan’s question as to whether, in the long term, the point of intergovernmental financial transfers is about broader global public goods than the definition that we currently have, which is around development—development itself, of course, being a word that is pretty elastic.

Q11 Hugh Bayley: It seems to me that you are arguing, and it is a view I share, that the foundation on which all ODA should be built should remain poverty alleviation. However, one needs to realise that, for example, work on polio eradication contributes to that. Work on environmental sustainability can contribute to that. I am putting words into your mouth; I do not want to.

Richard Manning: One has to recognise that the ODA definition does not say anything about poverty reduction or alleviation. It talks about development, if I am not wrong, which comes back a little bit to the conversation we have been having about whether Meles was right to invest in tertiary education.

Personally, I do not favour a very narrow international definition. I do not think it will work anyway. It has never been treated like that by anybody. It is better to do what we are currently doing, which is to set a series of outcomes that we all want to get. The MDGs are a very imperfect framework. There may be a better one under SDGs or post-2015, and then you can define in relation to that something that enables you to incentivise a reasonable amount of official flows across borders in support of those planetary objectives.

Q12 Hugh Bayley: Could I put one final question both to Elizabeth and Richard? It is a question that Jonathan has answered comprehensively—there is not yes. By very much difference between Lower Income Countries and Middle Income Countries at the margin, and many poor people’s needs need to be addressed through ODA in Middle Income Countries. Frankly, I do not share that view because the difference between China or India on the one hand, and Burundi or the DRC on the other, is that, if China or India, through public policy, chose to spend what was needed to get all children into school or to meet other development goals, they would have the resources to do so through taxing the better-off and middle class. However, we know in the DRC and Burundi those goals are completely unattainable without ODA.

China not only has higher, bigger foreign exchange reserves than the UK, but is bigger on a per-capita basis. The idea that we need to transfer money to a Middle Income Country such as China to help them abolish poverty is not a view I share. What view does Save the Children take from a policy-department perspective and, given your experience, Richard, what view do you take?

Elizabeth Stuart: I think you are absolutely right to say that there are big differences between countries such as China and India, and the DRC. This is not necessarily a Save the Children position, but I would argue that you should get rid of all these income categories because they are meaningless. As Jonathan said, they are totally arbitrary. You need to look at a set of criteria for each country based on how vulnerable that country is to falling back into a situation where you have higher levels of poverty or lower levels of per-capita GDP. You also want to look at non-income factors.

To answer the question specifically about China and India, it sounds strange and counter-intuitive but some very interesting research has been done on this by Martin Ravallion, who was at that time the chief economist at the World Bank, to show that India actually cannot fund its own poverty reduction. You would need such a high marginal tax rate to be able to do so; your tax rate would have to be in excess of...
100% to be generating enough revenue. Clearly, that is not possible. I would also counter the idea that India is not doing anything or has not been doing anything to relieve its own domestic poverty situation. For every pound that the UK was giving in aid, the Indian Government has been paying £400 in poverty-reduction spending. Clearly it is not the case that the country is doing nothing and other donors have been doing everything, and they can do it all themselves.

India is an example of a country that is not as wealthy as some Middle Income Countries, but it is not the poorest. There are Middle Income Companies that are more vulnerable as well, so the idea that you have these sort of arbitrary categories should not be dictating either our aid policy or our broader development co-operation and collaboration policies.

**Richard Manning:** Countries are clearly on a spectrum, and it is convenient to make some chaps every now and then, as perhaps happens. The Martin Ravallion thing is quite a good place to start. Some countries can more or less do most of it from their tax, and some require some assistance. With these big countries as Jonathan pointed out, aid has always been very small. The question is, is it catalytic? Does it change things?

From that point of view, I am quite sympathetic to the idea that one carries on some kind of relationship that encourages positive social change in countries like that. It is certainly the case that you need a very different kind of programme. It is also an area where less concessional flows are more the case, as with the climate finance example. No one is suggesting we give China lots of free money for climate change, but climate finance is a sensible position. If all India's money was spread down a gauntlet to traditional donors to improve the quality traditional donors I think they would say they prefer this new donor relationship. The area where we would need to see some kind of improvement is that those new donors have not yet signed up to the same kind of aid effectiveness agreements that the traditional donors have signed up to. While they have done so on a voluntary basis through the Busan process, they have not done so in any binding way, and that is where we would need to see some movement. Broadly, though, they are laying down a gauntlet to traditional donors to improve the game.

Q14 Chris White: One of the most effective means we have seen in a number of countries we have visited is microfinance. What is your view of how effective microfinance would be?

**Elizabeth Stuart:** It is not something that I necessarily have a view on. I do not know.

**Jonathan Glennie:** I am not an expert on it; in fact Claire here, from *The Guardian*, has read quite a lot if you want to catch her later.

My analysis from a non-expert perspective is it has been wildly overestimated as a magic bullet to development. Almost all the analysis coming out at the moment says that. Of course some entrepreneurs will do well when provided with small loans, but a huge amount will not. What happens then? There is an increasing amount of evidence suggesting that you need to invest in job creation rather than expect almost the burden of creating their own jobs to be placed on the poor. That is not how any of the developed countries developed. We developed industry. I would like to answer your other question as well, but I would just very quickly like to respond to Mr Bayley. If one’s vision of India as a kind of country doing well is everyone scraping by on $5 to $10 a day in a very precarious living, that is current. If Indian income was distributed equally—it is basically an entirely theoretical perspective that you are proposing because it is never going to happen.

Q15 Hugh Bayley: I am not suggesting that for one minute. I am saying if you go to a slum in Delhi and you suppose that the only way you could get a pit latrine dug every 100 metres through the slum is if foreign aid paid for it, that is not the case. Elizabeth makes the case that 0.25% of India’s spending on development comes from aid, so it is clear that our money is not what is critical.

**Jonathan Glennie:** I could not agree more.

**Hugh Bayley:** Maybe our expertise is critical, and perhaps they should pay for it.

**Jonathan Glennie:** I could not agree more. If your position is that India should never have received aid, and nor should the whole of South America, or any country that hardly received any aid, then that is at least a coherent position. I respect that. The idea that India now is in the position to pay for poverty reduction, whereas a few years ago it was not, I do not think is a sensible position. If all India’s money was spread equally, which is never going to happen, everyone would be dirt poor. There is not enough money in India to support—
Hugh Bayley: We should move on.
Jonathan Glennie: Yes. My answer to this is I would highly recommend some reports that ODI has carried out, called The Age of Choice, which look at the new donors, all the new sources of money, including some private sources. The reports look at it very much from a recipient-country perspective. In other words, we all know that there is this huge amount of money in the international ether, but when we look at Zambia and Cambodia, and look at which monies are doing what, I think that is quite a helpful perspective.

The role of DFID and its experience on effectiveness, value for money, issues like civil rights, checking on social environmental impact—all of those things we are seeing increasingly positively. A lot of the new money from new donors is much faster money, as Liz said, but may not have that focus on institution building or on social and environmental impact that has been such an important part of the last 10 years of aid effectiveness.

The work the African Development Bank and the OECD have done implies very much that, in Africa at least, there has been some implication that the Chinese especially are somehow in competition with DFID and other donors. There is probably an element of truth in that, in the sense that aid has complex motives. It is not just an altruistic action; it is very much related to politics and trying to get something. That is something that in Britain we sometimes prefer not to recognise.

The evidence appears to suggest that the new aid is quite complementary to other forms of aid—focusing on infrastructure where currently traditional aid, OECD aid, focuses more on social areas. Politically, it is important to be wary of criticisms of Chinese aid based really on competition.

The third issue is that the difference between now and 10 years ago, and Richard has touched on this, is that foreign private flows have massively increased, especially to Middle Income Countries but also to Lower Income Countries. Revenue has massively increased within Lower Income Countries as well as in Middle Income Countries. That transforms the role of international public money. It is going to be decreasing in all of those countries.

My final point is: how will the post-2015 settlement be financed? We always start to look at this thing called the financing gap. It is a little bit like the climate finance, which is meant to be 100 billion. It is private and public funds thrust together in this kind of mélange of “We need this money to achieve X”, but it does not look at the different role of different types of money. In other words, public money is very, very different, even if it is much smaller, than what private money can do.

Private money is basically motivated by profit and the market, whereas public money can be, hopefully, motivated by other objectives. I would urge the Committee, when they are looking at how much money is needed to require what development goals, not just to look at the quantity but also let’s call it the quality or the different types of money going into that mix.

Q16 Fabian Hamilton: Jonathan Glennie, can I just pick up on that last point? We have been discussing India, and whether or not India still needs development aid. Can I just put to you, and perhaps it does build on what you have said, that the real problem in places like India, apart from the obvious problem of distribution of income, is actually infrastructure and governance? If you had really good sanitation, for example, and proper local government, then you would go a long way towards resolving the problems of distribution of wealth, because that would help the poor hugely. How would you react to that?

Jonathan Glennie: I do not know India deeply, but I would say precisely it is the classic development problem of how external actors can engage in those kinds of systemic institutional changes. No one has worked out the answer. Sometimes external actors have helped; sometimes they have played a really negative role. It is difficult to know when that is going to be the case.

My point is not that I know how to support development and poverty reduction in India. That is a complicated question. However, I am convinced that there is a role for international co-operation in all countries in the world. India is one of the poorest countries in the world without any shadow of a doubt. I am convinced there is a role for international co-operation. I am also convinced that there is a huge financial deficit in India. I do not buy at all the idea that there is money in India. There is hardly any money in India.

Fabian Hamilton: That is effectively what you said, Elizabeth, isn’t it? There is not enough money in the whole of India to resolve its problems.

Elizabeth Stuart: Yes.

Q17 Fabian Hamilton: But I suggest that, like in the United Kingdom maybe 200 years ago, when we had rapid industrialisation and a very rapid growth of a middle class and the very rich through industrialisation, what helped equalise the distribution of wealth was local government and decent, proper sanitation—that actually helped public health enormously, and therefore the quality of life.

Can I just challenge you on one thing you said earlier in your opening remarks about the definitions of poverty? You used a dollar equivalent. Is there a definition of absolute poverty? Surely what $10 will buy you in the United Kingdom is very different from what $10 would buy you in Burundi or the Congo. How do we define what that money means? $1,000 a year is peanuts in the UK or the USA or anywhere in Western Europe, but it is worth considerably more elsewhere because it can buy more.

Jonathan Glennie: One dollar a day is actually worked out on what they call purchasing power parity. So it is the equivalent of having $10 a day in Britain, so it is incredibly poor. It is as if people were living with $10 a day in the UK.

Fabian Hamilton: I just wanted to be clear about that.

Jonathan Glennie: My line on that is yes, of course, we should focus on extreme poverty. I absolutely support that. These numbers—I think Ravallion might have come up with it—are useful to focus our minds on the poorest of the poor.
The danger is that sometimes there is the implication that, once the poorest of the poor are dealt with, we have eliminated poverty because there is no longer anyone living on under $2 a day. “Let’s move on to different countries or to a different focus.” No, that is extreme poverty. Let’s now move on to $5 a day, $10 a day, which is still incredibly precarious, or $20 a day, $30 a day. For me, that is the future of international development rather than withdrawal from aid because we have eliminated the very worst types of extreme poverty.

**Hugh Bayley:** With great respect, the question is who is “we”? I used to be the Minister on anti-poverty strategy in the UK—abolishing child poverty in a generation. I would not have expected America, a richer country than ours, to pay for our tax credits. The question is whether there comes a point at which a Middle Income Country can fund its own continuing raising of the minimum standard.

**Chair:** I am going to bring in Michael McCann. We are obviously teasing out what the role of development assistance is when the majority of poor people are in Middle Income Countries. That is what we are finding out of the inquiry about what more the UK can do. Do you want to comment on that, Elizabeth?

**Elizabeth Stuart:** Yes, just very briefly. Again, this is not an official Save the Children position, but we want to talk a lot about Martin Ravallion and his thinking, in this Committee. Here is an idea from him, and it comes again from this concept of what an appropriate tax rate is. If you are looking at affordability, when is it that countries can afford to pay for their own poverty reduction? He suggests that what seems to work in the majority of countries—a figure that there seems to be enough empirical evidence to support—is around $4,000 per capita GDP. That seems to be about the level at which a country could have tax rates that would be sustainable and would raise sufficient revenues to start dealing with these problems. There is an answer.

**Chair:** We will put that in the pot, thank you.

**Q18 Mr McCann:** Can I ask some questions about the most typical subject in international aid issues over the last 10 years? That is the 0.7% target. Richard touched in his opening remarks on the history of it, going back 40-odd years. I was just wondering, perhaps starting with Richard, if you think that the 0.7% aid target is both realistic and appropriate for the longer term.

**Richard Manning:** It has been effective in a number of countries—one has to say a limited number of countries. It obviously now includes the UK, which used not to take it seriously at all and in the last 10 years has taken it extremely seriously. You can throw all sorts of stones at it. I mean, if you try to construct exactly why it should be 0.7% rather than 0.6% or 0.2%, you could spend a lot of time doing that. So part of me takes a sort of conservative attitude to your question, which is, “We have got something; let’s not get rid of it.” Let’s encourage people to move towards it. Clearly, intellectually, and taking a longer term view, there would be reasonable grounds for saying, “Why don’t we try to look at this again?” Whether you will get an international consensus on what a figure should be, and what kinds of things it should cover, comes back to the peacekeeping point. You have got to decide what you put in this box if you are going to open it up and say, “Well, we should have a target for this.”

As I say, the point of a target is to incentivise people to move in that direction. It is never going to be a legally enforceable thing. It is not a bad idea, given that co-operation is one of the harder things to encourage Governments to invest in, because it is not immediately helping their citizens. Quite honestly, I am still torn between thinking, “We have this thing; let’s go with it, and keep it going for some longer time,” and thinking 2015 is a reasonable time to start thinking what sort of international effort is needed if we want to deliver outcomes by 2013, and what that implies.

**Elizabeth Stuart:** As I said in my response to the first question, I think there is still very much a need for it right now. I would agree that at a time when we are finding it difficult to find universal agreement on development co-operation and global public goods and all sorts of multi-lateral issues, it is an international agreement and it is agreed. There is public support for it, we are delivering it, other countries are delivering it and other countries are committed to deliver it. It would seem to be an absurdity to back away from that now.

Going back to first principles, what is the money there for? What is it going to do? We have done some calculations, and Britain’s 0.7% is going to send—we have talked a lot about children in school—an additional 16 million children into primary school, lift another 10 million people out of hunger, and avert 250,000 additional avoidable child deaths. This has real consequences, and it is money that can be spent and will be delivering development outcomes. I think it is very clear that we want to keep it there.

Just reflecting on something that Richard said, we have some concerns about some of the mission creep in terms of definition and use. Looking at the conflict pool, we are very supportive of the fact that DFID is prioritising governance and human-rights issues, which is what some of this money is being spent on within the conflict pool. We would be concerned if any more ODA was spent through the conflict pool, not least because it has a tripartite management structure, which means the allocation decisions are not always going to be driven by poverty reduction and humanitarian imperatives.

Also, we would be concerned if it were conflated or joined with other pools, such as the counter-narcotics pool, the counter-terrorism pool, where again they have explicit national security imperatives rather than development and poverty reduction imperatives.

**Jonathan Glennie:** The 0.7% target analytically does not make any sense at all; it is a number. The only discussion I think for the Committee is its political importance, and I leave that to you and Liz and those people engaged in the politics of it. I can quite believe that it is a useful target. In terms of what it actually means—not very much. Possibly moving towards a 1% target is quite a good idea. There are a couple of things I want to share with you—a little bit of what it might look like.
Firstly, the UN is very much more likely than the OECD or DFID to be making these decisions. If there is a point at which 0.7% is re-discussed, or the definition of ODA is re-discussed, countries like Brazil, China—South Africa has got its aid agency—and all of those countries are going to be very interested in how it is redefined. It is not going to be any more a decision for the OECD countries. The best idea I have heard about it, and Richard mentioned it earlier, was that politically it is important. If it incentivises countries/people/Governments to do the right thing, then it is important.

Q19 Mr McCann: With the greatest respect, Jonathan, speculating on whether it can be changed or increased is pie in the sky. The bottom line is it was set in 1969, 1970, and it has only latterly been achieved by very few countries, some of them very, very small indeed. We are the biggest nation that has achieved it, which is a significant milestone. To play devil’s advocate, isn’t there a danger that we are going to become isolated as a country? There is a lot of public support for it, but equally there is very much public anger about it as well, and it would be wrong to ignore that. Therefore if the UK stands out there, one of the biggest nations in the world delivering 0.7% alone when other EU states are not delivering it, isn’t there a danger that we will end up in a situation where those who describe it as a vice rather than a virtue are going to have their voices heard more strongly?

Jonathan Glennie: Again, that is a political analysis that you would be much better placed to know than I. I just go back to the idea that these targets generally are to incentivise good behaviour or best practice. To answer some of the questions about military, the US famously delivers a very small percentage: 0.1% or 0.2%. When you take into account US citizens’ contributions to global development, it is vastly bigger probably than the state contribution—bigger than what Britain does. I think those kinds of things also need to be incentivised. Private companies need to be incentivised to spend their own money on development. Why not?

Yes, military spending can be incredibly important for development. In some countries it is the most important thing that countries can do for development. Why is that not recognised? I am not saying it should be part of ODA necessarily, because again that is a political decision and you open the Pandora’s Box, but why not recognise that?

The best way I can think about it is some kind of annual award ceremony. “This year the US enabled private citizens to give a lot of money through charities. This year France delivered a lot of military spending for security and development. Britain delivered 0.7% aid.” It is those kinds of things, rather than seeing ODA as this kind of sacrosanct idea; there is actually lots more international spending required. Again, this is over the next five or 10 years, and that might be a way of responding to it.

Q20 Mr McCann: Perhaps Richard and Elizabeth can touch on the point I have made about whether Britain is in danger of being isolated. That would be useful, but the other part and final question from me would be whether there is a risk that climate finance, giving a focus on that particular issue, is going to overwhelm ODA in the coming years.

Richard Manning: Let me respond to that very briefly. First of all, it is very important that one has a much better handle on concessionality. At the moment, we are mixing apples and oranges too much, so that some countries are able to produce figures that require rather little effort from them because they are counting flows that are not really concessional because of how the OECD has chosen to do that. The same goes for a lot of climate flows, because many of them will not be grant-type flows. As under CDM, they will be investment-type flows, so one needs to calibrate all this both according to what is the money being used for, and how concessional it is. Those two dimensions always need to be kept in mind.

Elizabeth Stuart: Implicitly and explicitly, public support is 0.7% because all three major parties stood on a platform at the last General Election that had 0.7% in as a commitment, so there has been public support for it. There are different surveys that show differing levels of support, and it depends on the questions. Sometimes when it is explained to people how the money is being spent, there is evidence of much higher support for UK aid. It is an imperative for all of us, though, and particularly for NGOs, to be championing UK aid—that it is high quality and it is delivering. We need to be doing a better job of telling the story of what your pound does, how it is spent and how it is delivering good value for money and how it is making real change in countries. There are implicit and explicit benefits for the UK as well, so we are not just being good neighbours. There are positive externalities for the UK economy as well, and we need to keep telling that story.

Chair: There are sectors of the media that do not want to buy that story.

Jonathan Glennie: In my view, what Liz has just described is probably a mistake, and it is a mistake that has been made by charities for a long time. The danger is that all we do is become cheerleaders for aid. Aid does not always have a good impact. Certainly the recipient country public know all about the problems of aid.

I think the British public see through the NGO line on this, and I think analytically we should be much more open about aid sometimes doing a good job and sometimes doing a bad job. When we just present all the good things, one immediately just says, “Okay, but you are saying that because you are trying to sell me the thing.” We could say, “Look, most of it is really well used; a lot of it is really badly used.” When I read the Daily Mail when I read Ian Birrell and Andrew Gilligan having a massive go, they are making some decent points. I think we should integrate that into our analysis.

Chair: Yes, they are making some decent points. In some cases, they are making completely biased, uninformed points quite deliberately.

Jonathan Glennie: That is true.
Q21 Chair: We have to deal with that. Some of the time you are forced on to the defensive because you are under an unfair attack. Other times, I think you are absolutely right. This Committee, I think, has a reputation for being constructively critical, and we have been critical and we will be critical.

The debate has to be focused on what the real impact is, not what the perceived impact is. I give the example of our report last week on food security, and indeed the one we did on women and girls. I am coming to Pauline Latham. On our food security debate, the Daily Mail had a front-page lead that said, “Mad MPs want to ban eating meat”. All we said was eating meat on the level that we have in the West is unsustainable for 9 billion people; we may have to think about it. A perfectly reasonable proposition to make, but you would not have thought so if you were reading the front page of the Daily Mail.

Fabian Hamilton: The Daily Mail is not reasonable.

Chair: Sorry, did you want to comment on that, Jeremy?

Q22 Jeremy Lefroy: Mr Glennie, in the 1950s the target was 1%, but it did not specify what should be official and what should be private and what should be any other source. Are you really arguing that we should go back—and I think there is an argument for it—to that more global target? Should we be saying that, for people to be raised out of poverty throughout the world, we need to have this kind of percentage of GNI from the world or from the wealthy countries, which will be a mixture of ODA, private-sector remittances and so on, and that we are not particularly bothered how that is cut?

Jonathan Glennie: No, I would not quite say we are not bothered, but I think we should recognise and incentivise good things. Incentivising remittances would be a good thing. I am not saying that should be counted in the same number. I made this suggestion to a group of African countries a few months ago. I thought they were going to say, “What a foolish idea.” I was suggesting that countries like Liberia begin to contribute to international development, and the response was, “It is not such a bad idea.” Politically, the message that sends is relevant for Dr McCann’s question.

Mr McCann: You’ve promoted me.

Jonathan Glennie: Oh, Mr. Sorry, yes, Mr McCann.

Chair: It can only be a matter of time.

Jonathan Glennie: If you have got countries like Liberia and Sierra Leone demonstrating that, although they are poor, they are contributing some money to global public goods, it is hopefully an easier sell in countries such as this to say, “All countries are now contributing something to global public goods. We are richer so we will pay a bit more, but it is broadly the same proportion.” That is a new vision for international development finance rather than rich to poor. It is everyone contributing something according to their means.

Two more quick points: there is a danger that we are massively focused on aid. Everyone knows that aid, while being important, should probably be number 10 on the list of things that Britain needs to do to support international development. I am so pleased that taxes have become this mega campaign. It is far, far more important. Let’s spend an amount of time on tax proportionate to the importance it has to poor people around the world, and that is quite limited. The other things are way more important. Let’s spend time on that: climate change, taxes, regulating business—all those kinds of things.

The second idea that may or may not work is that there is quite a lot of evidence—and Charles Kenny’s book last year, Getting Better, is quite a good one—demonstrating that research travels well. Improvements in health around the world are not necessarily down to growth; they are down to 50 years of improvements in medicine. Improvements in climate research might well save our planet, not because of aid but because solar panels get cheaper. What if we took 100 billion of the 150 billion aid budget and invested it in research? And yes, including in Britain. Would that solve some of Mr—Dr McCann’s problems?

Chair: Professor McCann.

Chris White: Major.

Jonathan Glennie: British people were saying, “Why aren’t you investing in Britain?” Well, it is investing research in Britain, but for international development problems.

Q23 Chair: Richard, do you want to comment on that?

Richard Manning: First of all, of course research does count as ODA, and a lot of it is financed that way, so it is already incentivised. Secondly, on Mr Lefroy’s question, I would not favour a target that included commercial and private flows because they move up and down correctly in response to commercial decisions, so it is usually a meaningless target. If you look at any time series, it goes up and down like this all the time.

Jeremy Lefroy: We include CDC, which is commercial private flow.

Richard Manning: But you are including there a body that is given its resources by the state, and it is operating within that frame. Again, I do not really believe you need to incentivise remittances by this. What you do with remittances is cut the cost of doing it, and then people will do it themselves. The bit you need to incentivise is this official bit, which is otherwise hard to justify.

Q24 Pauline Latham: Last week we published our report on violence against women and girls. The issue is obviously incredibly important to DFID. What do you think are the implications for the spending of DFID because they are prioritising women and girls?

Elizabeth Stuart: Clearly, as Save the Children, it is an issue that we see as very important as well and we would favour you seeing it as a priority. It is very hard to measure impacts, so we need to do more research. So what is the metric you are looking for? That is where we need to be careful.

Richard Manning: It is a very tough issue, and a lot of it has to be done both with Governments but also very much with civil society. You are trying to make long-term societal changes here. Obviously, you can improve the framework in which it takes place, but
it has to be regarded as something that is very consistently addressed for a very long period in very smart ways.

Jonathan Glennie: I agree. Again, with the rise of other donors and pressures in the international sphere, I think that the role of DFID on this will become increasingly respected and important—not just DFID but some of the, let’s say, traditional donors that have made this a focus of their work. I think it is really relevant in almost all countries; when the international community is focusing on these issues, it really does make a difference.

Q25 Chair: There is a lot of cost involved in supporting civil society organisations. That is actually where the focus is. Do you see a significantly increased proportion of DFID’s budget going into that? We saw in Ethiopia that the Ethiopian Government has allowed DFID to fund local groups to run effectively educational social awareness programmes, which are quite intense in terms of having to get right round the country and having quite a lot of people to mentor and lead.

Richard Manning: Potentially. Obviously, the situation is different in different countries as to what you can and cannot do. I think particularly building civil society capacity in developing countries, not just for service delivery but also for challenging and monitoring what is going on, is a hugely important part of progress in almost every country.

Chair: Thank you very much. You have thrown quite a lot of things into the pot, which will stimulate further discussion both within the Committee and with other witnesses. Thank you very much.

If on reflection there are any things that occur to you that you feel you can add into the mix, please do not hesitate to get back in touch with us; we are very happy to have any further comments or supporting evidence. Thanks to the three of you very much indeed for coming in.

Examination of Witnesses

Witnesses: Peter Chowla, Co-ordinator, Bretton Woods Project, Matthew Martin, Director, Development Finance International, and Professor Stephany Griffith-Jones, Columbia University, gave evidence.

Q26 Chair: Good morning, and thank you very much for being here. I think you were all in for the previous session, so you have got some flavour of what we are about. For the record, could you introduce yourselves?

Peter Chowla: I am Peter Chowla, from the Bretton Woods Project.

Professor Griffith-Jones: I am Professor Stephany Griffith-Jones. I am the Financial Markets Program Director at—sorry, it is a long title—the Initiative for Policy Dialogue at Columbia University, and I am research associate of ODI.

Matthew Martin: I am Matthew Martin, director of Development Finance International.

Q27 Chair: As you know, we are looking at the future of development assistance right across the piece. The previous discussion demonstrated it is not just about money; it is about ideas and policy priorities.

One of the things we are interested in is the actual mechanisms and instruments. I wondered if you could very briefly give us a flavour of how the world is changing. We have seen a whole mixture of different capital flows going from developed countries to developing countries. Some of it is obviously private, perhaps not always effectively monitored. On the other hand, some of it goes through very specific institutions.

I wondered if you could perhaps also tell us where you think development banks fit into that process. We really want to consider the role of development banks, and how DFID can best engage on that front. I do not know who wants to start with that.

Matthew Martin: It is a fairly rapidly changing landscape, but sometimes people exaggerate the scale of the change, particularly for the types of countries that DFID is focusing its resources on. Of course there is foreign investment, remittances and all the other things out there. If you actually look at the key countries DFID aid is intended to help, the key source of net financing, and I say that very deliberately, is concessional flows.

Why do I say “net” deliberately? There are a lot of figures out there that talk about foreign investment and forget to count in remittances, profits and dividends that come out on it, which often countries do not record very well. That takes away somewhere between two-thirds and three-quarters of the benefits to the countries in terms of foreign exchange. If one was looking within the concessional flows, again there is a diversification. If you had about 180 billion globally of those flows in 2011, about 10% of that was South–South co-operation.

I was hearing in the previous session Jonnie saying that it would be a good idea for countries like Sierra Leone and Liberia to be contributing. They already are. Every country in the world is giving some degree of co-operation to others. We work in partnership with several West African organisations that are funded out of the budgets of those poor countries, and help other countries in their region. There is about 10% of that, and that is up a lot from about 3% 10 years ago. About 15% is coming from civil society organisations and foundations.

In terms of what actually gets to Lower Income Countries’ budgets to finance their investments in reducing poverty, still about 60% to 65% of that is concessional money, whether from DAC donors or South–South. If you look at that landscape, we work with about 50 Lower Income Countries to help them work out what they prefer in terms of financing, and what will do the best in terms of impact and value for money. They say that they prefer the really good bilaterals, like DFID. They prefer the multilateral organisations for various reasons, which I am sure we will come back to later.
Then they would put the global funds, because although they have very high results, they do not engage very well with local civil society or local government. Finally, they would put things like development banks and development financing institutions in the last place. I think they would say that fairly publicly. Most recently there is a letter going to G20 Finance Ministers at the moment from all Lower Income African Countries saying, “We would like to see you give really good replenishments to IDA and the African Development Fund rather than putting money into bilateral development banks or global funds.”

Professor Griffith-Jones: You broad point is of course very important; I think there is a very significant change across the world. Last week, I was speaking here at another panel about the possible emergence, for example, of a BRICS Bank. As there is a shift in economic power to the emerging powers, there are of course greater foreign exchange resources and a greater ability to fund South–South co-operation. Nevertheless, I think that the level of resources that Martin has referred to is still relatively small. As regards whether they are focused on areas that are very concentrated, and a big part of them are very volatile. For example, at the moment we see great enthusiasm with so-called exotic markets in Africa, but we have seen that before. Sometimes that withdraws in a very volatile and cyclical way.

The main point I am making is that aid and concessional flows still have a very important role to play, even though the landscape is changing very rapidly. One of the very interesting issues among those that you were raising in the overall questions we were sent is whether part of the grants for countries that are not so poor and vulnerable could be used as concessional loans, as a number of donors have been doing—the French, Germans, Japanese and others. This may be quite an interesting trend that it will be quite valuable for you to consider in the sense that this allows more leverage. If you have more blending, you obviously have more leverage.

There is a nice paper by Nick Stern, Amar Bhattacharya, Romani and Stiglitz that shows the scale of the needs just in infrastructure and climate mitigation. It is massive across the developing world. If you need more financing to support the growth of this actually happening in developing countries, aid on its own may not be big enough—particularly in the context of some developed countries cutting back aid. The UK, of course, is an honourable exception, as you discussed earlier.

There is this idea that you could do more with less, but they have to be there. Another advantage is the issue of moral hazard, in the sense that if you have to pay it back, even if it is at very low interest rates and very long maturities, I think there is some kind of incentive to spend the money better. I would not push that argument too far, but I think it is important.

Of course there are risks. One risk is the avoidance of future debt crises. The second risk is to continue funding concessional very poor countries and activities where social benefits are much higher than commercial returns, such as climate adaptation and so on. If you take care of that, for example by having mechanisms like the French have, which are interesting—the counter-cyclical lending of the Agence Française de Développement, which gives debt holidays in years when countries are hit by shocks—that could facilitate protecting countries from having costly debt crises, and protect donors from having to deal with that. I think that is also a shift that is occurring, this shift towards the possibility of blending. I understand that may be something you are considering.

Q28 Chair: Peter Chowla, perhaps I might ask you to comment. In a way, Matthew Martin, when you said what they prefer, they would say that, wouldn’t they? If you say to somebody, “Would you like us to give you money or would you like us to lend you money?” I do not think it is much of a choice. Surely the point Professor Griffith-Jones is making is it actually might give you more options and more flexibility and extend the money. I think that is what we are trying to tease out.

I have no doubt at all that people like grants, but I think the question we are wanting to establish is whether DFID is inhibited by the fact that it only gives grants other than funding multinationals. Of course, 60% of its money goes through those, so indirectly DFID is of course giving loans, but not loans that are directly administered by it. So I do not know whether Peter Chowla would like to comment on that.

Matthew Martin: I was not commenting on grants and loans. I am sure we will get to that later, and I have got quite a lot to say about that. I was commenting on institutions—what types of institutions they feel produce the best results and work best on the ground.

Chair: All right, but there was a connection between the way they deliver it.

Matthew Martin: No. I am in favour of concessional loans, but we will come back to that, I am sure.

Peter Chowla: I think it is very important also to think about the orders of magnitude we are talking about in terms of resources available for development. So while private flows have been increasing dramatically, and Stephany has talked about some of those, we also have to remember that domestic resources are always much bigger than anything that is available, and the more we can do to benefit countries able to garner and generate more domestic resources, the better off they are going to be.

I think you heard a bit of that this session when Jonnie talked about tax revenue being a key driver of how countries can invest. I think that is quite important, because if you look down through the list of different kinds of international cross-border flows, you are talking of the order of 20% to 30% of GDP in terms of domestic revenue and going down to a couple of per cent when you talk about aid or private borrowing or Overseas investment, FDI. So those things are quite small.

Coming on to how that works in development banking, it is important to also recognise that development banks have started to change quite drastically in the last 10 years, moving towards greater emphasis on private-sector investment and private-sector flows. We are not clear that that has always
been well borne out by the evidence as delivering good value for money or effective development results. So whereas the World Bank had only about 10% of its resources working on private-sector investment where it did the most work about 10 to 15 years ago, it now has a full third of its resources working on private-sector investment, roughly speaking; it is about a third of the total. You will see the same trends happening in the African Development Bank, less so, as well as the Asian Development Bank and Inter-America Development Bank. You will see some of the same efforts moving in towards more private-sector investment.

At the same time, you have also seen more resources moving in towards financial deepening, which is the word they use to describe investment in the financial sector of developing countries, or of financial-sector investments related to developing countries, rather than in projects. An important trend to recognise is that, as we move towards this, we have less information about value for money and development impact. That is one of the important things to think about as we think about development banking models, how they are changing themselves, and whether they are going in the right direction, which is the point that Jonathan Glennie made in the first session about matching the type of resources to the type of investment you want.

Aid money has a particular usefulness because of its public nature. Development banking money, which might be in the private sector, has a different usefulness, and might need to focus on different sectors or different kinds of outputs or investments and outcomes. Public-sector concessional loans from multilaterals or from bilateral agencies, which are debt creating in nature, also need to think very carefully about what they are being invested in, so that we are not putting them all in a pot together and saying, “Well, there is this massive pot of money, and now let’s use it.” They need to be carefully and strategically used for different kinds of things because of the debt-creating nature of them, the governance arrangements over how they are controlled, and potentially the purposes and strings that might be tied to them.

Q29 Jeremy Lefroy: One of the reasons why we are asking this question about development banks and development finance is that on our visits we have increasingly seen that as DFID, quite rightly in my view, concentrates more on the private sector than it has in the past, which in the past has been very limited. We are seeing money go into things that could be repaid, and yet are not being repaid. If they are repaid, it is then just left in the country.

We saw an example with Pakistan, where there were guarantees that we thought were very good for small and medium businesses, but once the guarantee has been repaid, it is then just left in the country. And when you point out, go into profitable projects where the money is there, and it would be more cost-effective to put the money to work there. If DFID is interested in particular countries or sectors, it can take the lead, get co-financing from the other countries to avoid excessive transaction costs, but putting a particular mark from its development perspective and the perspective of the developing country in the way it channels the flows. This is an advantage over just giving the money through the World Bank or other multilateral channels.

Overall, it is a good issue to think about, taking the world they use to describe investment in the financial sector of developing countries, or of financial-sector investments related to developing countries, rather than in projects. An important trend to recognise is that, as we move towards this, we have less information about value for money and development impact. That is one of the important things to think about as we think about development banking models, how they are changing themselves, and whether they are going in the right direction, which is the point that Jonathan Glennie made in the first session about matching the type of resources to the type of investment you want.

Aid money has a particular usefulness because of its public nature. Development banking money, which might be in the private sector, has a different usefulness, and might need to focus on different sectors or different kinds of outputs or investments and outcomes. Public-sector concessional loans from multilaterals or from bilateral agencies, which are debt creating in nature, also need to think very carefully about what they are being invested in, so that we are not putting them all in a pot together and saying, “Well, there is this massive pot of money, and now let’s use it.” They need to be carefully and strategically used for different kinds of things because of the debt-creating nature of them, the governance arrangements over how they are controlled, and potentially the purposes and strings that might be tied to them.

Q29 Jeremy Lefroy: One of the reasons why we are asking this question about development banks and development finance is that on our visits we have increasingly seen that as DFID, quite rightly in my view, concentrates more on the private sector than it has in the past, which in the past has been very limited. We are seeing money go into things that could be repaid, and yet are not being repaid. If they are repaid, it is then just left in the country.

We saw an example with Pakistan, where there were guarantees that we thought were very good for small and medium businesses, but once the guarantee has been repaid, it is then just left in the country. And when you point out, go into profitable projects where the money is there, and it would be more cost-effective to put the money to work there. If DFID is interested in particular countries or sectors, it can take the lead, get co-financing from the other countries to avoid excessive transaction costs, but putting a particular mark from its development perspective and the perspective of the developing country in the way it channels the flows. This is an advantage over just giving the money through the World Bank or other multilateral channels. Overall, it is a good issue to think about, taking the precautions of avoiding future debt crises and taking away funds from important projects, which may require grants or a highly concessional loan. I think there is a third level, where you could then, as for...
example KfW does, make almost market loans to Middle Income Countries or very advanced LMICs, but that is a bit different.

**Peter Chowla:** I might leave some of the questions around debt sustainability to Matthew, because I am sure he is more expert in those questions than I am. However, I understand that has to be a key element, because though we have committed a lot of money to debt relief through the MDRI process in the UK, it is not clear that many countries have emerged from debt overhangs.

There is a wide variety of countries, and one of the most important criticisms that civil society has had is that the Debt Sustainability Framework, which is what the World Bank and IMF use to determine what type of concessionality to use, has not been as effective as it should be in terms of monitoring private sector debt, which has an impact on the potential for financial crisis, or for dealing with the questions around social needs—whether countries have sufficient levels of resources to invest in education, health, job creation or anything else that they want to invest in. So there is some worry about the Debt Sustainability Framework and, as I said, I think Matthew is a bit more expert in that than I am, but that has to be a key element of it.

Secondly, you mentioned that DFID could potentially be a good model of how a development bank would work. It is important to recognise that, to do development banking well, there is a lot of infrastructure that would have to be built around that—an incredible amount. As you will see from some of the civil society work that we have referenced in our written submission, the supposed expert institutions in this that we work on—for example, the European Investment Bank, the IFC, the World Bank—have not yet got there in terms of the internal institutions they need to do this well, in terms of measuring development impact effectively, doing results, doing independent evaluations and accountability mechanisms, and social and environmental safeguards.

In all those areas, there is still much work to be done; these are institutions that have been doing it for 30, 40, 50 years and still have not cracked the right model. So I am very, very wary about setting up new institutions thinking that the UK could become a model provider so quickly, because it is really complex, particularly where you are doing things like private-sector work or project work on the ground and you are doing loans for these things.

The social and environmental safeguards are really complex and the need to have people on the ground to monitor, supervise, course-correct and take feedback, and even project design at the very beginning, is very intensive. My understanding is that, so far, the perspective from secretaries of state both in the previous Government and this one has been to try to reduce DFID’s overheads and administrative footprint, if you will, in terms of number of staff.

**Q30 Jeremy Lefroy:** Can I just come back to you on that? That is not the case. On the projects, the DFID staff have increased greatly, and the ones they have recruited have a lot of those skills that you have just been describing as necessary. So I would say that it is a very good value-added use of these people that they have those skills already, the ones who DFID has been recruiting, so you would not need vastly to increase the infrastructure.

**Peter Chowla:** To scale up the amount of resources you provide in this way, you will have to scale the number of staff commensurately, and I think currently DFID staff is probably not at the level where you could provide large levels of concessional loans or borrowing terms with this level of assessment and supervision of projects. It is about the scale.

**Professor Griffith-Jones:** I think that Peter has made some really good points, but you could, for example, work very closely, where they exist, with national development banks or local Governments. Therefore, you can start reinforcing their capacity. Also, you can work, as I mentioned before, with existing institutions like the World Bank or, even better maybe, the regional development banks, where there is a lot of expertise, and you have your own expertise as well.

So I do not think that the resources have to be so burdensome. Also, I have been at meetings with developing countries with a minister in India said, “What we value most from the World Bank is not the money but the engineers and the technical expertise, which we transfer.” In that sense, the UK and DFID could do that well.

**Matthew Martin:** There are two different questions here. One is what we think about concessional loans, and the other is whether that means we need a development bank. On the concessional loans, I think most countries would be relatively happy if DFID were in a position to offer them. They are already borrowing quite a lot of concessional loans and, indeed, being pushed to fund infrastructure and so on into much more expensive loans. You will have noticed some of them are borrowing on bond markets; some of them are doing off-budget PFI deals, in very much the rather regrettable, extremely high-cost way that we have sometimes done in the past here. So I think the alternative of having lower cost concessional loans would probably be very welcome to them, provided of course that we do not make a profit out of this. As was mentioned in the previous session, some of the donors are already lending at more than their cost of borrowing. It seems to me a bit usurious if you are going to start lending at 2% or 3%, so we would need to keep it pretty concessional at 1% interest or less.

On what we would need to do to have safeguards, clearly we would need to have not just the World Bank and IMF Debt Sustainability Framework and a very low risk of countries having a debt crisis in future, but our own assessment within DFID of whether the country would be able to afford to repay. Focus those loans on high-return projects, so that would mean really transformative infrastructure projects where we could see that that was going to have a high impact on growth and development. Focus above all on public-sector projects, because that is where the real funding gap is.

On the capacity issue, it seems to me that you could rely a lot on other institutions’ capacity and you could develop a certain amount of capacity yourself to
assess project returns and work with local Governments. It would also be important that DFID developed the capacity to do the creditworthiness assessments and also probably provided more support for debt-management capacity in those countries that are receiving the money, which they have pretty much abolished in recent years. If you are going to start lending, it seems to me we should be helping countries to be responsible borrowers as well.

That does not mean that we should then move into establishing a development bank. For me, the really good model for all of this is something like AFD. I know that officially under French law that is a bank, because it has to be, but what it is is an executing agency for French Government development policy, grants and loans and, indeed, equity. It does not set up a separate institution. It does not have all the risks and some of the negatives that have been seen over the years in places like JBIC, which is why the Japanese Government merged the Japan Bank for International Co-operation back into JICA.

There are all the risks of fragmentation, of donor-driven projects, of informal tie-in, where the relationship between the private sector and the contractors and the development bank is so close that always the British contractors, in this case, would find out about things before anybody else and there would sort of be a tie-in and, therefore, a very severe risk of reduction in value for money and increase of costs. So there are all kinds of real disadvantages to setting up another institution. Above all, in a situation where we have budget constraints and we are having our bonfire of quangos and trying not to set up more independent institutions, the idea that DFID, when there is already the degree of public controversy there is about the aid budget, would be in the process of setting up a whole new institution would seem really likely to undermine public support for development assistance in this country.

For me, you could have something that I would call a “virtual” bank, where you would say, “DFID will now lend money for the countries that can afford it and for high-return projects,” but keep it within the programming and planning framework of DFID. The goal would be poverty reduction, funding the private sector, making sure it is untied and focusing on DFID’s key countries, and bringing in the idea that you would then co-finance, so you would need less investment and a huge amount of extra staff capacity and overheads within DFID. That would seem to me to be an ideal midway solution that one could adopt.

Matthew Martin: There is one thing that I think we may need to bring in. I broadly agree with what Matthew has said in the current context, but one interesting thing is that, for example, the Labour Party is talking about a British investment bank and a national development bank for the UK. Indeed, this Government has a Green Bank and so on. So one could think that, if you had a significant development bank for UK purposes, as the EU has with the EIB or Germany has with the KfW—I am not sure we are going with exactly that model, because that is not exactly the tradition, but there may be some trend towards that—there may be a case that within that there would be a lot of synergies and spill-over effects towards doing something similar for developing countries.

I am talking about this more in the medium term as this Green Bank evolves or as a British investment bank is created. Then there could be a part of that—say, 10%—that would focus on lending to developing countries. Obviously, it would have the disadvantage, as the EIB lending to developing countries has, for example, that there is not enough focus on development, but it would have the big advantage of having all these trained engineers and people who work in the same sectors.

Chair: We have a series of questions that are about how a bank might work.

Pauline Latham: My questions have been answered.

Chair: You are satisfied with the different institutions. We understand DFID is considering whether or not it should establish a bank, so I am going to ask other colleagues whether they want to pursue the questions just to establish, if it did, what it could or could not do.

Q31 Fiona Bruce: I am very interested, Matthew, in hearing you talk a little bit more about the French model, because on one of our visits to France we did talk with a representative from the French bank and were very interested. If I am right, that is their exclusive route for aid, apart from private-sector donation. Am I right? How would that work if we had one working in parallel with DFID’s other aid delivery?

Matthew Martin: The answer is it would be best not to have one working in parallel with DFID’s aid delivery. The last thing you want and the negative experience of JBIC as well as KfW from the point of view of recipient countries—and, indeed, that is why the previous German Government spent about 10 years trying to merge the three different institutions they have—is that when you are on the ground in a developing country, you have a massive amount of fragmentation.

I have seen this recently in the last few years in relation to German and Japanese aid in quite a few countries, where you effectively have a Government talking with two different voices, with different priorities, with different things that they are telling you. Frankly, you are never really sure, as a developing country Government, whom you are dealing with. You have one lot of people telling you, “Infrastructure is our top priority,” and another lot telling you, “Poverty reduction is our top priority,” to caricature it slightly. You are never quite sure whom you are talking to and how to really get an effective dialogue with the Government, so I think it would undermine Britain’s credibility and leverage in dialogue to have two separate institutions.

Why I was saying that AFD is a positive experience is essentially that it is the implementing arm of all French aid. It is a bit like Swedish SIDA or Canadian CIDA, until it was abolished recently, where you have the ministries taking the political decisions about what they would like—so the Ministry of Foreign Affairs, the Ministry of Finance in France—and you have an implementing agency, and it does grants, it does loans
and it does equities. My view would be that, if you were going to do this, you could do it within DFID. You could have some kind of unit whose responsibility it was to say, “We will assess creditworthiness and we will work out the return on the projects, make sure that it is a good idea to lend in this case, and organise the co-financing with the other organisations.”

The other really bad thing is it is not just about policy and dialogue; if you have two different organisations, you risk having to do lots of procedures, and that can really complicate everything. You are never quite sure why the delay is happening, who is really responsible for the project not delivering its impact, apart from all the issues Peter raised about accountability and results and so on, which a lot of those development banks do not have a great record on.

For me, the reason I raise the AFD model is it is not about splitting it. It is about bringing those loan opportunities into the existing development institution.

Q32 Fiona Bruce: So if we were going to go down this route and build the capacity within DFID, what kind of recruitment would we need to undertake?

Matthew Martin: I do not think you would need a lot. I would like to think that DFID would want to focus on some pretty large transformative projects where you could really have the extra impact in the money that you could use in a development bank. It would be, for example, in multi-country regional infrastructure projects that would connect up the whole of Africa and make intra-African trade much greater, or in power projects or in telecoms projects that would bring IT to everybody. There are lots of those really big projects that you could join in.

The projects exist. You often hear that there are no bankable projects out there, but there are a lot of bankable projects out there. The two problems are that people have problems preparing them and they do it very slowly, so if DFID were in a position to be co-financing these other organisations, it would give them a chance to have leverage over them and really kick them to move faster in terms of preparing things and getting things done.

The other one is the problem that, as DFID, you might not have specific skills in infrastructure. I already knew a bit, but I am very glad to hear that DFID has been recruiting people on the infrastructure side, because that is important. However, I do not think you would need to have massive numbers of additional bodies in DFID, because you could say, “We just need to be sure that we are happy with this.” So a few extra skills on the debt management side, on the creditworthiness assessment side and on the infrastructure side, and then you could say, “To some degree we will rely on these other organisations, but we will still have the choice to say no to a particular country or a particular project if we do not want to fund that for our own bilateral reasons.”

Q33 Fiona Bruce: One of the advantages that I perceived was, effectively, you were circulating this money. You were lending it many times over, when it was recovered, and that was a really exciting alternative to our current approach.

Matthew Martin: That is true, and particularly if you did not, over the long term, use that as an excuse for reducing the new flows, but you would be getting it back and be able to build on the new flows. Effectively, what would then happen is that your 0.7% growing over time with GDP could probably be financed or partly financed by the reflows from those loans.

Q34 Fiona Bruce: Do you not think the administrative burden then on the recipient countries would be that much greater, because those projects are already, by and large, going to happen?

Matthew Martin: Yes, they already have debt-management systems. As I said, some additional investment by DFID in supporting that debt-management capacity would be helpful to some of them, but they all have debt-management systems. They all have projects that they are already doing with other organisations, so I think it would be a question of DFID fitting into that additional structure. Provided you did not have the two parallel organisations, which would create an additional administrative burden at the other end, it would work very well.

Q35 Richard Burden: In the various models we have been talking about and you have been talking about today, where would CDC fit into the picture, if anywhere?

Peter Chowla: I might come back on one point that stems from something Matthew said about the regional transformative projects. There has been a lot of concern among some civil society actors about how these are prepared and what they are aimed at. It comes to some of this question about what role the private sector plays in how these projects are being designed and delivered. A lot of the worry about some projects that are being developed is that they tend to be more about extraction of resources or export-oriented models without dealing with the internal development of markets in Africa, like Matthew talked about. I think that is an important distinction. Whether projects are considered pro-poor and dealing with job creation prospects for giving decent work, as they talked about in the morning, or whether they are oriented towards export infrastructure is an important distinction. One of the things that we think is very important is how you engage with recipient priorities, both recipient Governments and the ultimate beneficiaries, who are the people of these countries. We have particularly had worries about the ability to take in beneficiary feedback or priorities for infrastructure development.

That comes to the CDC question, because the CDC largely invests through private equity funds—well, previously only through private equity funds, and now, still predominantly through private equity funds—in emerging markets. We have a lot of questions about the development impact of that and the ability of that model of lending to really reflect the priorities of poor people or their needs in terms of infrastructure or other kinds of projects.
DFID did a CDC review a few years ago. We have a new model as of about a year ago. The jury is still out on whether the CDC is effective in terms of implementing this new model and whether this brings it far enough. As I alluded to earlier, we have had a lot of evidence that development impact is not well measured in the private sector. The more that private-sector projects can be driven by the priorities of the Governments in recipient countries and by beneficiaries or people, the ultimate beneficiaries, rather than profit-oriented interests, the more likely we are to see that those projects have good development outcomes.

We have been quite critical of the commercial orientation of a lot of development finance and the seeking of very high levels of return, above what you would expect from domestic investment in a rich country. For a few years, the IFC was making 20% to 30% returns on equity. That sounds fabulous if you are a private investor, but does not sound very good if your purpose is the real transfer of resources from rich countries to poor countries. When you are taking 20% to 30% back every year, after three or four years you have lost more than you may have put in. That is not a particularly helpful perspective when what you are aiming for is the real transfer of resources from rich countries to poor countries.

I am not clear about reforming CDC again as a separate, stand-alone institution or trying to bring it into DFID. I think it is quite clear that the model CDC has followed for the last 10 years has not been effective in delivering development results.

**Chair:** The Government has tried to change it or is in the process of trying to change it.

**Peter Chowla:** It has, yes, and as I said I think the jury is still out on whether those changes have gone far enough and are effective, and I do not think we know enough yet; it has been too soon. As future development co-operation agendas are set, it is important to look at that again to see whether this reform has been enough. We are quite sceptical of the model the CDC uses, and especially having it as a stand-alone institution, without the mandate, oversight and supervision that might come with being within DFID, makes it even harder to ensure that it is effective as a development outcome provider.

**Q36 Richard Burden:** If there were a virtual bank, the way you have been talking about that, there are two questions. First of all, what would the relationship be, if at all, between CDC and that virtual bank or would that just be separate, whether reformed or not? The second thing is, if there were a virtual bank, I am still trying to get my head around what it would do. I can see that it could be the executive arm, say, for implementing DFID’s programmes, but if it was a virtual bank as opposed to just a virtual executive arm, could it borrow money itself on the market?

**Professor Griffith-Jones:** I was thinking about that. If you are lending to Middle Income Countries, yes, it could borrow money, because then it could borrow more cheaply, like the EIB or the African Development Bank does. Then it would transfer that cheapness to developing countries. However, if it is to lower income or even lower middle income countries, I think the subsidy element is very important, because you really want very low interest rates and long maturities, and you will not get that on the market. You may do some different kinds of blending, but I think there would be a very significant contribution precisely from the grants. I do not know if you can separate the financial engineering. In your next session you will have people from KfW and they could maybe discuss it. I tried to talk to them, but it was not very clear from the material they sent me whether they raise money in the market for financing these very subsidised loans.

**Chair:** The French Bank does, I think.

**Jeremy Lefroy:** The AFD does.

**Matthew Martin:** Yes, exactly. The AFD does as well. I would probably say that, ultimately, if CDC is about development and not just purely a private equity fund with a little bit of Government capital, it should probably be brought back into DFID as a private-sector wing, if you like. What they do in AFD is have a thing called PROPARCO, which basically does all of their private sector financing through a combination of quite expensive loans and equity financing. They have other equity funds as well, the terms of which I will not bore you with.

So I think you could quite easily envisage CDC continuing to be an equity provider. The fundamental reform that has been made in recent years is CDC does not give loans, because they were not very good at them and were quite a major contributor to the debt crisis that we saw before. So I would say CDC’s relationship with a virtual bank would be different, because why have a virtual bank? Essentially, you want to fund public-sector, high-return projects in developing countries, notably infrastructure projects but maybe some productive support ones as well. You also want to be sure that you have a unit at least where you are able to keep a very close eye on whether countries were able to repay and what the likely return of the project is going to be. That is why you have a virtual bank rather than just do it through DFID regional departments at the moment—to have some kind of unit where you can do that.

On Stephany’s point about the British investment bank and Middle Income Countries, it might well be that, if we ever got to the stage where we had a really well functioning Green Bank, British investment bank, we might want to consider letting that institution invest or lend to Middle Income Countries on commercial terms.

However, I do not think we should mix that up with giving concessional loans for probably lower return projects in Lower Income Countries, which is DFID’s function. It may well be that that British investment bank could make some very good returns in China and South Africa and other places where it might want to invest to help develop green technology and so on, but that would not seem to me to be something where you would want to use subsidised UK resources. I would separate the two.

**Professor Griffith-Jones:** There are, for example, experiences like Norfund in renewable energy that I have been studying a little bit, and they seem to do quite well. They argue that they get commercial
returns; it is not as high as Peter is saying, rightly, 25% or 30%, but they say that on average they make about 13% a year for investment in renewable energy in relatively poor countries—in Central America, but also in sub-Saharan Africa.

I found that very interesting, because when I talk to a lot of the private pension funds and insurance companies about investing in renewables, they first say to me how much they would love to do it, but then they say, exactly as Peter said, “We want 25% or 30% return. We are not getting that, and because it is so risky, we are not going to do it.” The people at Norfund said, “No, no, we can handle the risks in Africa,” and they were very businesslike about doing it, and they seem to be quite effective. If you have that kind of spirit, I think that might work rather well, but that is a little bit further down the line.

Peter Chowla: Can I make one further point? Peter and Stephany have brought out the issue of blending. Part of the idea is that you might take public resources, grant resources, aid resources and blend these with commercial loans from the private sector. This needs to be done very carefully, because, number one, you put yourself at risk of subsidising corporate profits. They already have access to finance. We have seen this a lot with the IFC investing in Marriott Hotels and Coca-Cola bottling plants. The parent companies have plenty of resources. We do not need to use development resources for these things, so we need much more careful assessment of the development and financial additionality of some of these things.

It is very clear that you would have to try to build in a very important factor for social benefit—public goods, if you will—if you are going to use public resources to invest concessionally in the private sector. You would not want to put in your public resources for any old business opportunity. That is not the point of some of our aid resources, which are limited. You would want to use these much more clearly for things that might have a lower commercial return or potentially no commercial return, but have public benefits associated with them.

Things like renewable energy are exactly the kind of example of where, right now, we are facing a need for climate change mitigation; you might consider there are broader social benefits that might be subsidised in that effect, but you have to be very careful. You talked in the first session about the Daily Mail; imagine it getting hold of stories about subsidies for corporate welfare for executives who get paid £1 million and fly around in private jets. That is not going to look very good either, so you have to be very careful about how you do those sorts of things.

Chris White: That is not new.

Peter Chowla: More of them I suppose is what I mean.

Q37 Mr McCann: Can I ask you a couple of questions about the relationship between multilateral and bilateral aid? DFID is routinely praised for being a world leader in the international development field, yet they give 60% of their budget away to multilaterals. Therefore, if six-tenths of the budget is going to multilaterals, the argument could be that we are very, very good at giving our money away.

The one thing that has always perplexed me is, if we are the only major nation in the world that is going to reach 0.7%, we are in a situation where the Government is artificially trying to hold back administration costs on its core budget but yet seems quite content and happy to authorise administration costs of nearly 5% in the EU, 8% in the World Bank and possibly even more than that in other multilateral organisations.

My question is: do we have the right balance between bilateral and multilateral aid? We have had answers in the past about economies of scale and why multilaterals operate in areas where we do not, but are you saying that multilateral aid is a good model? Do you believe it is working well on the ground?

Peter Chowla: Multilateral aid has its benefits and its detractions. We have to be very clear there is no silver bullet, and I think you heard some of that this morning. When you come at it from the aid effectiveness agenda, so when you look at the issues of donor harmonisation and fragmentation, it is quite clear that putting more money through multilaterals would be better, because you will have fewer donors for recipient countries to negotiate with.

However, at the same time, you will also then empower a certain institution in a negotiation with a recipient country, and whether that institution is working effectively then becomes very, very important, if you are talking about the African Development Bank or the World Bank or any of the other regional development banks. By putting money through multilaterals you amplify the power of that multilateral and its potential faults, as they were. Some of the paper that Jonathan Glennie referenced, The Age of Choice, talked about how competition of some type between different providers of resources can help recipient countries in their negotiating positions to get resources that have the maximum benefit for their citizens, if they are well organised and strategic about how they do that. That is a big “if”. That is about good governance states in recipient countries that are effectively maximising the use of those resources.

We have been quite critical of multilateral institutions. We think there is lots of room for improvement. We have the luxury of doing that in the UK because DFID is such a very good provider of aid on its bilateral programmes. For me, it is very easy to be critical of multilaterals, where our option is quite good; DFID is quite a high performing aid-giver. It is much harder for our colleagues in other countries around Europe to make that argument, because they know that their bilateral resources are not flowing in the most effective way. So there always has to be a trade-off, and which is going to be the most effective needs to be assessed in every situation.

One thing the UK can do is work much harder to make the multilaterals more effective. There has been a lot of great work done from the UK and it has been a leader in pushing multilaterals on things like gender, fragile states, and the results agenda. Those are very welcome improvements in the multilaterals that DFID is largely responsible for, as the leading agency asking
for those things. Where it can do a lot more is on the independent evaluation and accountability front. This is where I think a lot of the multilaterals are still falling down in terms of learning from mistakes, taking on board lessons from evaluation, not being defensive about failures, and ensuring greater accountability to the beneficiaries of projects or programmes in developing countries where citizens have a complaint about how things have operated. I think DFID could do more in pushing those things and governance reform at the World Bank and the other multilaterals to ensure that multilateral resources are more effectively used, not only DFID’s own but those of others.  

Professor Griffith-Jones: I think this is very important to increase the effectiveness of the multilaterals, but it must not be done by being too intrusive and intervening all the time at every step, particularly in adding all these things—what we used to call “Christmas tree conditionality” in the 1980s. It is important to listen a lot to what the developing countries are saying. I found it interesting that Matthew was saying that African developing countries like the World Bank and the African Development Bank more than others. I think it is very important not to add too many conditions, even if it is done with the best of intentions, and to listen a lot to the developing country Governments—and, indeed, also to the direct beneficiaries, as Peter said. That is quite a tricky thing to do, because the idea is always to try to micromanage things, and I think that may be dangerous, even though done with the best intentions. The philosophy of strengthening the multilateral system is a good one, which has been the British approach. I think overall it is a good one. There have been problems with excessive conditionality and so on of the Bretton Woods institutions, but there is a natural answer to that in the emergence of these new donors and these new development institutions, like the Chinese, the Brazilians and others, and the possible BRICs bank. This comes back again to your initial question, Mr Chair, of the changing architecture as the flows are rapidly changing. That is something that should be kept in mind as you are designing the new architecture for the UK.

Matthew Martin: Just to come back to what I said at the beginning, there are some very strong reasons why people on the ground see multilaterals as being preferable not, I would say, to DFID bilateral money, but, for example, to some of the other rather less well performing bilateral development banks and so on. Those have to do with them genuinely aligning with the country’s own development priorities and making sure that there is national-level ownership. For example, particularly the African Development Bank has been decentralising to country level, so that it can be closer to the local recipients, and that has been very much appreciated. So there are a lot of reasons why the idea of DFID is not necessarily the answer. Peter also came in, notably in the case of the African Development Bank, very quickly to help with the impact of the global economic crisis when it first hit countries. From a DFID point of view, what they offer is the possibility for wider reach, because they can fund countries that DFID has no intention of setting up country programmes in. In recent years, when we have reduced the number of countries that we have put money in, we have said to Burundi or Latin America, or whatever it may be, that we will now channel money to them via the multilaterals, so there is a reasonably strong case for that.

Q38 Mr McCann: With the greatest respect, our job as a Committee is to scrutinise the work of DFID and to make sure we are getting value for money for the British taxpayer. Peter makes the point that multilateral systems fall down in certain areas. Therefore, you cannot just say that there is a recognition that they fall down in certain areas and then do nothing about it. Surely there has to be a conclusion reached. If certain multilaterals are not delivering what we want them to deliver, and if we are seen as being a good bilateral deliverer ourselves, why wouldn’t we, for example, ramp up the programme in Ethiopia to deliver on our plans there about violence against women and girls? Why wouldn’t we do that—divert money from the multilaterals and put it back into our bilateral programme, where we believe we can get more value for money? Would that lead you to the conclusion that the balance between bilateral and multilateral should change? You cannot recognise that there is a problem with some, but then not propose a solution.

Matthew Martin: Just to come back to what I said at the beginning, there are some very strong reasons why people on the ground see multilaterals as being preferable not, I would say, to DFID bilateral money, but, for example, to some of the other rather less well performing bilateral development banks and so on. Those have to do with them genuinely aligning with the country’s own development priorities and making sure that there is national-level ownership. For example, particularly the African Development Bank has been decentralising to country level, so that it can be closer to the local recipients, and that has been very much appreciated. So there are a lot of reasons why the idea of DFID is not necessarily the answer. Peter also came in, notably in the case of the African Development Bank, very quickly to help with the impact of the global economic crisis when it first hit countries. From a DFID point of view, what they offer is the possibility for wider reach, because they can fund countries that DFID has no intention of setting up country programmes in. In recent years, when we have reduced the number of countries that we have put money in, we have said to Burundi or Latin America, or whatever it may be, that we will now channel money to them via the multilaterals, so there is a reasonably strong case for that.

What I would urge you to do, as a Committee, is to look much more closely at the administrative cost issue, because I think the multilaterals are much more honest and transparent about the level of their administrative costs than some bilaterals are. They do not eliminate the administrative costs relating to country programmes or to individual projects and put them down as country projects or country programme costs. So you might want to ask the multilaterals to report their admin costs on that basis, broken down into different types of admin. Then you would see that they come much closer to the levels of admin costs that bodies like DFID have, or at least the more effective ones do. I entirely agree that, if they are ineffective, you should not be giving them money, and I was glad to see that you eliminated money to a few in the last Multilateral Aid Review. Just on this issue of how you influence the multilaterals, because I think that is really important, there is no doubt that DFID has been punching above its weight, partly because it has been increasing the amount that it gives to these organisations, and has achieved a huge amount in changing the way they behave. There is a lot more still to do, but giving the money gives you the power to do that.

I am not necessarily convinced that we would need to carry on increasing the share of multilaterals. I think 50/50 would be a perfectly reasonable balance. One of the things that Stephany mentioned when we were talking briefly about this yesterday was co-financing the projects that we were talking about earlier on in terms of infrastructure. That would still give you the leverage, and it would give you the option to say to the World Bank or the African Development Bank, “We are not going to fund this particular project,
because we think it is rubbish,” or “we do not like the Government” or “we think you have taken too long to design it” or “it does not have the returns we want”.

This sounds an awful cliché, but I think you need to treat them mean to keep them keen. You need to basically say, “We would like to carry on supporting you, but we would like to give you money in a co-financing format and for particular projects where we think you have been doing a really good job.” That would help, as well as continuing to give a major core contribution to them, to encourage them to do better, but I think co-financing would help.

Q39 Chair: Can I pick up on that, because I have a couple of questions and we are three-quarters of the way there! It has been said to us that DFID gives 40% to core funding and about 20% effectively in partnership—exactly the kind of co-financing we do. Is there scope for them to do more in that context?

One thing I am interested in exploring is, for example, having regional offices that could do bilateral programming outside the bilateral programmes, where appropriate. One of the points that have been made to us is that we are quite effective at knowing what the World Bank is doing in those countries where we are partnering them bilaterally. We are much less effective in knowing what they are doing with our money where we are not.

Perhaps having a regional office, say, in South America or an Africa office or a South Asia office that specifically has a small capacity to engage bilaterally with the World Bank or the Asian Development Bank or the African Development Bank on agreed projects in that context can increase the accountability. What you were suggesting, Matthew, seemed to me to imply that that might be a way to go.

Matthew Martin: Partly, I am sure the others will want to talk about this, but there is one thing I would say. That sounds like a very good idea, but I would really strongly urge you to think about something that allows DFID to get the money out quickly and to have the maximum impact with the least administrative cost.

Quite a lot of that 20% is currently trust funds and separate earmarked trust funds for multilaterals, which typically have 20% overheads taken off them immediately and also need a lot of admin time for DFID and for the multilateral concerned; they are a terrible idea. So what I am not suggesting is that we should go around creating more trust funds.

Chair: I meant joint project funding.

Matthew Martin: Joint project funding—yes, exactly, for the type of projects we were talking about earlier and for the loans.

Professor Griffith-Jones: I think the regional office idea is a very good one, having people on the ground, and also making sure that the World Bank listens. I remember I was on a mission in Eastern Europe and we had a meeting with the same minister about the same sector, and there were World Bank representatives waiting; I was representing the UK. He said, “Why don’t we merge the meeting?” and they said, “No, because we are the World Bank.”

That kind of attitude has to change, and in that sense you are both right to say that you need more accountability, but having more presence would be very necessary. We are talking about a virtual bank and all that, but if you are disbursing money in loans, it would be good to have some more engineering skills in the projects. If you are going to be doing, say, regional infrastructure, you will need more, and you can have people in the countries or in the regions, plus you work even more closely with local Governments, local development banks, where you are using more the local expertise and not relying just on the World Bank, the EIB and so on.

Peter Chowla: A key addition to that is further internal accountability and transparency within the World Bank. Where DFID has regional offices, that is great and can help, but the more the World Bank can internally do its own independent evaluations, much like we have ICAI here, and to do them more publicly and more transparently, the more that will help DFID know what is happening to its money.

Chair: That is fair enough.

Q40 Jeremy Leffory: With other countries reducing their ODA quite substantially, what you are getting is an increasing pressure on the UK to increase its contributions to multilateral organisations. For instance, the Global Fund wants the UK to put up its contribution quite substantially. IDA has its replenishment coming up in 2014 to 2016. The UK has traditionally been one of the highest donors—either the first or, in the current round, the second largest.

It seems to me that, because these organisations see DFID’s budget as, indeed, increasing this year and then stable, it is often the country that they are coming to almost first for that. I see that as a real problem. Do you think DFID should be much tougher on them and say, “We will not increase unless we see other countries increasing. We are not prepared to make up the gap. You may say you need £21 billion in the next IDA round, but frankly, other people need to step up to the plate. We are not going to fill the gap”? 

Professor Griffith-Jones: It is a very difficult question. One interesting issue there is whether the decreases in aid of the other donors are temporary, hopefully, or permanent. To take one example, the Spanish had been increasing aid quite significantly and then they have just slashed it now because of the crisis. This is understandable because of the depth of the crisis in that country, but I do not know, if the crisis were to be resolved relatively soon, whether they would then recover a certain level of growth, although perhaps less than now.

If it became a permanent trend, I think you are super right that you cannot continue to carry the entire burden. If it was a bit more temporary, perhaps you would be more willing, up to a point, obviously, to do that. I am not sure. In the World Bank I have been arguing very strongly for increasing the voice of developing countries on the boards. One way of doing that is also from the financial perspective, because if you do that, you would get money from the Chinese, the Brazilians and a lot of the Asians. There is a source of money there that particularly certain countries, not necessarily the UK, do not want to give...
up, so that might be an alternative to reflect these new trends in the world economy.

Matthew Martin: I would say two things. One is there are already a lot of developing countries making increasing contributions to multilateral organisations. Some of the biggest funders are making between 25% and 40% of their money available—notably Brazil, for example—through multilateral organisations, so they are aware of this. We could probably do more to encourage them in that direction.

If I take the analogy of the 0.7%, I would hope that no British Government would have said that because nobody else is trying to reach 0.7% we should not try, and we should not try to use that as means to encourage them all to do better. I think a lot of the softening of the cuts in other countries, except in extreme circumstances like Spain, where they have no choice, has been because of the comparison effect—people do not want to look completely out of step, so they will not slash their aid budgets. They will still pretend they are increasing them or increase them a bit.

On the same grounds, I certainly do not think it would be appropriate for Britain to say, “We are not going to give any more money to these organisations, because nobody else is.” That would just be encouraging everybody to cut back and those organisations to have no funds. My view would be that Britain ought to be demonstrating a strong commitment to those organisations, as it has done for the last 10 years or so. Maybe that is about where we are getting to in terms of a limit of the share of DFID’s money that could be allocated via those organisations, but the real issue for me is: if we are putting money through them, how do we make sure they deliver?

Some of this slightly more complicated leverage—that we do not just put money into core funding but we think about co-financing individual projects or co-financing for countries where we feel there is a need to get involved and where we cannot get involved as DFID because we do not have a country programme—is probably part of the way round that. Peter Chowla: I would concur with the first half of your statement, which is that we need to be tougher on them when we are giving these replenishments and deciding whether we should increase. However, we should condition that not on whether other donors are delivering but whether the organisations are delivering and whether they are reforming internally to deliver appropriately and effectively.

That includes governance reform, which needs to be a key metric of whether the institutions are adapting to the new international environment. It also includes things like development effectiveness, development impact monitoring and accountability on environmental and social issues, etc.—all the issues we talked about earlier, which are the things we need to see them delivering better. Those are the metrics we should be using in terms of whether we should be committing more money to things like the IDA or the African Development Bank.

Chair: Thank you very much indeed. First of all, you have commented on some of our ideas and put a lot of your own into the framework. I will say the same to you as I said to the others: if, on reflection, you have any further thoughts, please feel free to feed them in to us. This is very much the beginning of our inquiry, and at the moment we are teasing out a number of different avenues. We have no preconceived views. Individual members of the Committee are leaning one way or another, but I think we genuinely want to get the evidence as to what might be the best centre of gravity for what DFID might do. Clearly, it is going to have to change, but there are quite a lot of different options for the way it changes, some of which obviously have more merit than others. Your contribution has been really helpful towards helping us think that through, so thank you very much indeed.
Tuesday 2 July 2013

Members present:
Sir Malcolm Bruce (Chair)
Hugh Bayley
Fiona Bruce
Jeremy Lefroy

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Examination of Witnesses

Witnesses: Owen Barder, Senior Fellow and Director for Europe, Centre for Global Development, Andrew Rogerson, Senior Research Associate, Overseas Development Institute, and Peter Young, Director, Adam Smith International, gave evidence.

Q41 Chair: Good morning, gentlemen. Thank you very much for coming. Can you introduce yourselves so that we have that on the record?

Owen Barder: I am Owen Barder from the Centre for Global Development.

Andrew Rogerson: I am Andrew Rogerson from the Overseas Development Institute.

Peter Young: I am Peter Young from Adam Smith International.

Q42 Chair: Thank you again for coming in. This is the second session we have had on this, and we are particularly looking at different financial models. As you know, the UK this year has announced that it will reach the 0.7% that we have been working towards for the last few years. I think everyone on the Committee wholly supports and welcomes that, but I think we also recognise that the background development situation is changing pretty rapidly, so we are looking forward to the next 10 or 15 years with regard to whether or not the model needs to change as the world changes. First of all, would you briefly like to share with us your thoughts on how you think it has changed and will change over the next, as I say, 10 or 15 years? What are the key factors you can see emerging now that will perhaps justify either a different approach or a different mix of approaches from where we are now?

Andrew Rogerson: May I start? Thank you very much for having us. You have heard quite a lot about how the world panorama is changing, particularly the location of poverty and the nature of global challenges. I do not think it is really that necessary to cover the whole landscape, but two particular points are worth drawing your attention to. Poverty will almost certainly be concentrated more in fragile states. They have particular needs, and the track record of development in those areas has been a tough one, and not totally successful one. That is across the spectrum of instruments.

Secondly, we are in a world where we have to produce global public goods, including fighting climate change, and that is not just a matter of money but also a matter of smart international collective action. I will stop there, with the mention that for both of those things you will have to be more, rather than less, multilateral. That panorama has implications in terms of the nature of international development action, simply because you need to have scale and reach, you need to have the depth of expertise, you need to have convening power, and you need to have objectivity and neutrality, none of which are in the purview of any single state, and of course some states are better at it than others. I will stop there; we can talk about instruments later.

Chair: We will explore those in more detail.

Owen Barder: I agree with that, obviously, completely. I would add a couple of observations. In the changes we see, with a large number of new actors coming into development finance and the changing shape of development financial flows, and not only new donors but also private investment and remittances coming in, one question is what should happen to the British aid programme in the face of that. There is a tendency to say, “We should be doing more of what everybody else is doing. Everyone else is making more private loans, either hard loans or concessional loans; shouldn’t we be doing some of that? People are getting more engaged in infrastructure and private-sector growth; shouldn’t we be doing more of that?” I would argue that the proper response is to think about what we should be doing more of, in the light of what everyone else is doing. We should probably be sticking to the things that we already know.

We have learned lessons about how to deliver aid effectively over the last 50 years. That means we should continue to do that, and not follow the new donors into less effective ways of giving aid. The fact that there are more people giving money into less effective ways of giving aid. The fact that there are more people giving hard loans and concessional loans should focus us on the areas where aid can make most difference in grant form. I think we should resist the tendency to be pulled into doing more of what everybody else is doing, because if aid does not focus on the very poorest, most marginalised people, who will? That is money that will reach people that those other sources of finance probably will not reach. I think we should resist the temptation to be like children playing football, where everybody follows the ball, and be more like adults playing football, where we hold our position on the pitch and do the things that each of us is best at.

If I may add to Andrew’s point about multilateralism, he is absolutely right that in the world we will see in 30 years’ time, there is a stronger case for multilateralism, but there is also a stronger case for multilateralism right now. It is not just that because the world is changing we should be doing more multilaterally, but there are strong biases towards bilateralism that I think are unhelpful, and we should...
be, in any case, looking to spend more money through the multilateral system. We can talk about that if the Committee wants.

**Peter Young:** I think the UK aid resources are increasing to the 0.7%, but still it is a relatively small drop in the bucket compared with the overall needs, and we should be trying to leverage those resources to maximum effect, trying to achieve the maximum amount of transformational change. I agree that the focus on the fragile states will continue, and the more difficult areas in which to operate. That means that having high-quality, fast, effective capability in our aid programme is particularly important. I would suggest that by and large the track record shows that multilateral institutions have not been able to demonstrate that—rather the opposite. While we may well need to put more money through multilateral institutions in order to address climate change and other major factors of that nature, and have them operate as development banks, in terms of fast, effective assistance, they are not very good.

Lastly, we need to do what we can to leverage the private sector, particularly in the poorest countries. I thought it was very encouraging that Bob Geldof’s latest initiative was to set up some kind of private equity fund. That kind of imaginative thinking is something we should be looking more into.

**Q43 Chair:** Thank you. I have a couple of supplementary questions. You say that poverty, Andrew Rogerson, will be concentrated increasingly in the fragile states. Yet what we are being told is that hopefully—because we are concentrating on them—there will be fewer fragile states, and in population terms they will not account for most of the poorest people. We are told, for example, if you talk about the bottom billion, that about 850 million of them will be living in middle-income states that are not designated as fragile. That raises the question: if we are going to concentrate only on grants, is it really sensible that one of the biggest donors in the world should simply give up on the multilateral institutions? Does that make sense?

**Andrew Rogerson:** First, if I may offer a clarification, about 80% of the world’s poor currently live in— you can play around with acronyms—CHIPIN: China, India, Pakistan, Indonesia and Nigeria. The latter three of those are fragile states. I think of Nigeria, think of Pakistan and others that are quite dramatically, although admittedly at different speeds and from different starting points. It is not either/or. There will be fragile middle-income countries: think of Nigeria, think of Pakistan and others that are quite large and populous. There will also be some countries that are not middle-income that may become middle-income over time.

I think increasingly the issue of at what point you cross a statistical line called “middle income” will become unimportant. The basic conditions—“Is the government committed? Is it capable of making use of external resources?” —are the real driver.
tax rates of over 100% to solve the poverty problem in India. The average income per capita in India is still $10 per day. That is well above the $1.25 absolute poverty line, but it is still less than one third of the poverty line in the United States. You simply could not redistribute all the money from the wealthiest people in India and solve the poverty problem there. The fact is that the British aid programme in India, until it finishes in 2015, will be providing nutrition to 3.5 million kids. It will be sending 700,000 children to primary school; it will be sending another 700,000 children to secondary school. That will not make a huge difference to India’s growth prospects or to the performance of its private sector, or to its overall public spending numbers, but it is a very serious issue for the 3.5 million children who will get extra nutrition, who would otherwise be stunted for the rest of their lives.

Q47 Hugh Bayley: Could I pick at that a little bit? It would not make sense in the UK for us to say, “In order to finance Government programme x, we intend to increase taxation rates for high earners,” because that is not how you would do it. When you were in Government, you did not say, “We have a particular regional development agency, and it will all be funded by higher levels of income tax on the top 25% of earners.” You would look at a whole range of instruments for funding regional development, or whatever the project might be. I think the example you use—“Surely the middle class can pay 110% of their income in tax”—really is not a very helpful example.

Owen Barder: My point is you cannot do that.

Q48 Hugh Bayley: No, but do you understand what I am saying? Simply to say the only way the Government of India can raise money is by having ever-higher rates of income tax on the better off is not a sensible way to manage public finances. The point I am making is a rather wider point about whether India is in a position for redistributive personal taxation to pay for one third, or two thirds, or 90% of its development spending. It is somewhere on that gradient. Shouldn’t we be saying that countries that have got beyond the DRC or Mozambique point should be generating their own resources, and that one should set a gradient? Somebody once gave us figures, didn’t they, which said that your internal resources will allow you to finance your own development when they are— I forget what the level was—$1,000 a year, or something like that, or a couple of thousand dollars per year. Should one not build that in as part of a development paradigm, so that the Indonesias and Indias recognise, as they already do, through that policy—

Owen Barder: Yes, and I was just looking for the reference. Development Initiatives is producing a paper in September on the sources of finance for poverty reduction, and what it shows is that, not just in India and China but across the developing world, Governments are spending much more of their own resources on social services, health, education, and poverty reduction, including things like social safety nets. That is where by far the biggest increase in development finance is coming from: it is coming from developing countries themselves. That should be encouraged, supported and helped.

Q49 Hugh Bayley: Should that be codified into the post-2015 framework in some way—some model of a good middle-income aid recipient?

Owen Barder: I do not think there is anybody, anywhere in the development system, who does not want to see, in the end, every country in the world able to finance its own social services, its own economic infrastructure and private-sector growth, and all those things. I think we have been somewhat seduced by having set a very, very low poverty line of $1.25 a day, and saying, “If people are getting across that poverty line, this country is now wealthy enough,” or a very low status for middle-income status, which is $1,000 per person per year. That is not a good signal of whether a country is yet in a position to provide all its basic services for all its people and deal with pockets of poverty, and many of those countries will still need external financial support. Even if they are making great progress and spending more and more of their own resources, that is not a reason for us to walk away from them and say, “You do not need us anymore,” because many of them still do.

Chair: That is a very interesting philosophy, but I think we need to get more of the detail.

Q50 Jeremy Lefroy: Good morning. I would like to ask a couple of questions about the type of financial instruments that may be required to meet the UK’s development objectives. It seems to me that in development you have two particular kinds of finance. One is obviously the more technical assistance, where you are helping the country to build up its ability to deal with a particular problem—to set up a social transfer programme, governance in the private sector, or whatever. Then you have actual funding for those programmes, and sometimes I think there is not enough analysis or discussion of whether those two things should always go together. It is often the case that you get both the technical assistance and the funding to go with it. With the private sector increasingly being seen as incredibly important to development, in the sense that it generates 90% of new jobs in the developing world, so we are told, and therefore generates the tax revenues and helps to lift people out of poverty, and given that DFID is therefore concentrating more of its funding on the private sector, which ought to be able to return at least some of the funding it is given—as we have seen in some of the projects we have visited, whether in Pakistan, through bank guarantees, or in Sudan and elsewhere through the Africa Enterprise Challenge fund—we now have a kind of mix of funding in DFID where it is all grant but some of it effectively should be returnable capital. It is going to
the private sector, and they can easily afford to return it, but there is no mechanism for doing that. How should DFID respond to this? Let me ask that question first, and then come with some follow-ups.

Peter Young: I think that the situation differs in different countries and regions. If you take somewhere like Nigeria, I do not think the problem is a shortage of money. There is lots of money sloshing around Nigeria—quite a lot of it is sloshing into this country too, and elsewhere of course—but for profitable ventures, you can find finance. There are more serious problems that prevent people from accessing that finance. For example, only about 3% of the population have titles for their land and property, so they cannot get bank loans because they do not have collateral. In that case it would be much more effective for DFID, as in fact it is doing, at least in some states, to try to tackle that issue and a range of other issues that prevent people other than the elite accessing finance. As we suggested in the evidence paper we put in, one could try to encourage more direct UK private-sector investment into these countries by providing tax incentives for investment, either equity or debt investment, along the lines of the seed enterprise investment scheme, or the VCTs that we have in this country. That may well throw up all sorts of different initiatives that would, again, be more tailored to the particular circumstances of the countries concerned. A “one size fits all” setting up of some additional development bank, which would take a very long time to do and build up its own bureaucracy and whatever, would seem to me not to be the right way to go.

Q51 Jeremy Lefroy: Why do you think it will take a long time to do, and why would it necessarily build up a lot of bureaucracy? Would it necessarily have to be something separate? Could it not be from within the Department, as it is at the moment? After all, they are doing some of those things; they are just not acknowledging it, and not putting them on one side as a department of capital that is returnable, as opposed to that which is made by grant.

Peter Young: I guess there is nothing wrong with starting more of those types of programmes in some of the countries, where perhaps there is a particular need and there is no other way of fixing the problem. Usually these programmes, like the Africa Enterprise Challenge Fund, are run by a private-sector organisation—I think it is KPMG in that case—who have the expertise to implement the programme. They are not setting up some new huge organisation or department staffed by civil servants, who are, because it is public money, extremely nervous about everything that is spent, and everything basically goes towards a very risk-averse model, because there will be a row every time a load of money gets lost and so forth, and your Committee will investigate. I am not sure it is the best means of providing such finance, but perhaps a more experimental approach might work. There already are a number of these development banks, none of which are noted for their particular speed and flexibility, it must be said, although some are better than others.

Andrew Rogerson: May I add to that? I tend to share this view, but for another reason also: one of the success stories of DFID that is recognised is combining a very large portion of the UK’s external aid effort under one roof, and then being present in-country with that same sort of unified voice. We should be careful. If the answer to a problem is concessional loans or guarantees, then DFID already has the powers, as I understand it, to do those. They may need more capacity and more skills—we can talk about that—but it should be very careful not to throw away that advantage by creating something apart from DFID that then adds to the general fragmentation in-country and does not necessarily dovetail with how taxpayers’ money is being used in other forms. Concessional loans potentially have their place, and the world will probably need more of them, including through IDA, the EIB and other people you will be talking to, but not necessarily as a free-standing, brand-new bank that one would magic up, with all the transaction costs that might involve.

Owen Barder: The 2002 Act does give DFID the powers it needs to do this kind of thing. The world absolutely does not need a new development finance institution.

Q52 Chair: That is not the view of the World Bank.

Owen Barder: It may not be the view of the World Bank. DFID is in a position to make sensible choices about the right mix of grant and concessional loan and hard project finance.

Q53 Jeremy Lefroy: Could I come back on that? You may not have the figures—we do not—but how much in the way of concessional loans has DFID made, say, in the last 10 years?

Owen Barder: Effectively none.

Andrew Rogerson: I think none.

Q54 Jeremy Lefroy: So it has the power, but it has not used it?

Owen Barder: It has not used it, but it could and should choose to use it. It is perfectly reasonable to say there are many circumstances in which that is something DFID should be doing.

Q55 Jeremy Lefroy: Could anyone say why they think DFID has not used this power, even though it has it?

Peter Young: I think the DFID funding can be often used to greater effect and create greater leverage if it is not simply provided in the form of a concessional loan. We do a lot of work in the PPP area, and everyone is enthusiastic about attracting private-sector funds into infrastructure, but the overwhelming problem is not the lack of finance, concessional or otherwise. It is the lack of bankable PPP projects, because not enough work has gone into creating those projects and addressing the underlying problems. That is a fairly expensive process, but not nearly as expensive as financing infrastructure itself, so I would say it would be better to put your money into creating
Q56 Jeremy Lefroy: That is exactly what PIDG—the Private Infrastructure Development Group—is supposed to do. It is precisely the point I made: if you do have or develop bankable projects, at some point they need to be paid for by the people who develop them on a commercial scale, which is what PIDG does, and therefore this returnable money is, in effect, what we are talking about. There are some things that DFID is doing at the moment along those lines, but it is not recognised as being returnable. It gets lost in the ether. I do not think anybody is particularly necessarily saying that the only answer is to formalise this into a development bank, but should DFID not do a lot more to identify these and really get to grips with them? At the moment we feel this money is often wasted. It disappears. I think there was the expression used earlier that money is lost. I think it would be a very interesting exercise to go through and say, “DFID has been giving several billion pounds a year over the last 10 years—so probably something in the order of £60 billion to £70 billion. How much of that has had some effect?” We do not know. I am sure even the Secretary of State could not tell us precise figures.

Peter Young: Giving money to what—generally?

Jeremy Lefroy: Yes, generally, whereas if you were doing something through concessional loans, the very fact that it is a 30-year loan means you have a track record of what has happened to that project over the 30 years. In 30 years’ time when the loan comes to be repaid and the project does not exist because it is a white elephant, you have some accountability there, which you do not have in terms of having made a grant 30 years ago.

Andrew Rogerson: We should not forget that DFID can and does invest in the likes of IDA, which does essentially loan-based operations over 30 and 40 years, the EIB, from whom you will hear later, and others. That might be one reason, Sir Malcolm, why the World Bank is perhaps happy to have more friends around the block, because they can co-finance. They do not necessarily have to be the designer and the architect of every operation; they could come in and slipstream behind some of the other bigger fish. There is definitely a possibility of doing more on concessional lending. We are using the word “concessional” knowing that this is a very blurry story at the moment, but I use it to mean—as I think one of your other witnesses, Matthew Martin, said—well below 1%, something that cannot create unsustainable debt bubbles in the creditor countries.

Q57 Jeremy Lefroy: One final question, which is a bit more specific: we have read in evidence, I think from ASI’s Development Resources Trust, about development impact bonds, which are very interesting, and certainly need to be explored. Do you think there is a role for DFID to play in that, or should it just leave the market to get on with it?

Peter Young: In the case of the specific instruments that require UK tax incentives, you would need, I think, DFID to lead the process of designing the appropriate intervention or series of interventions, and negotiate with the Treasury. I think it would be appropriate for the cost of those tax incentives to come off the DFID budget, but last time I looked, the cost of tax incentives for the venture capital trusts in the UK was £80 million, which is not an absolutely vast figure. A lot of useful economic activity is created through them.

You could either go down the route of creating a specific vehicle, such as the Development Resources Trust that we suggested, which would be private-sector-run funds that would collect money from retail investors, have onboard expertise, and invest in particular projects—a sort of venture capital trust model—or you could simply provide a tax incentive for any investment, as we do through the Seed Enterprise Investment Scheme in the UK, where very small investment projects attract a high level of tax rebate. That would possibly lead 100 flowers to bloom and all sorts of new initiatives to arise, some of which then might be suitable for subsequent concessional finance, grant support or whatever, depending on what they were. I think it would be an interesting route to go down.

Owen Barder: If I may add to Peter’s point, the development impact bond proposal, which is modelled on the social impact bond proposal that you are familiar with—used, for example, in Peterborough prison—has private investors, social impact investors, putting in private capital to produce results, but those results are typically results that do not yield a financial flow of benefits. In the case of Peterborough prison, it is a reduction in recidivism, which is of benefit to society, the economy and the taxpayer, and in that case the savings come to the Ministry of Justice in lower prison costs, and the Ministry of Justice then remunerates the investor for the money they have put in.

In the case of development impact bonds, where very often a developing country Government would not have a financial benefit that would enable them to remunerate an investor for the results they have produced, if you have an investment that does not itself have a financial revenue stream, you might well look to a combination of the developing country Government and donors to remunerate the investors. There would be a clear role for DFID in creating this market by promising that it will repay the social impact investors for the investment they make in producing certain results in developing countries. DFID would need to figure out the legal and financial mechanisms, the procurement rules and so on, to enable them to do that.

There is a certain amount of work to be done to put them in a position to do that, but it is potentially a very powerful instrument that DFID could be using to pull through private investment into social results in developing countries.

Q58 Jeremy Lefroy: Are there any examples of such bonds in existence?

Owen Barder: There is an example currently being worked out, not yet committed to, to tackle sleeping sickness in Uganda, which would involve private
investment to roll out the services, but it needs a donor—and I hope DFID could be one of those donors—to promise to repay the investors if the results are achieved.

Q59 Fiona Bruce: Good morning. We have heard on this Committee often that grant funding decisions are made in a very short time frame. I wonder whether, with reference to leveraging in more private sector investment, we need to look again at the returns from investment. Do we look too short term, and should we be engaging in the exercise of looking more medium and long term at the outcomes and the outputs of investments when we are looking at private sector partnering? How could we do that?

Peter Young: I think that we should, across the board, be looking more at how to measure the outcomes of the investment made by DFID. There is a tendency, when you cannot measure some of the harder-to-measure things, to only put money into the very easy-to-measure programmes. There is not nearly enough done in looking at proper cost-benefit analysis across the whole piece. Of course, if you are talking about some of the specific investments we are making alongside the private sector, it is perhaps in some senses easy to measure some of those, because the private sector is trying to measure the effect of the investment.

However, many of the things DFID would do would be more to create the enabling environment for private-sector investment. For example, we are working on a project at the moment to try to tackle the absence of electricity in Nigeria. There is a lot of private-sector investment coming in—indeed, some billions are lined up behind the current privatisation of the industry—but none of that will occur unless tariffs rise to an appropriate level, which in fact they now have, and unless assorted other technical issues to do with gas supply regulation and so forth are fixed, but the returns on that are absolutely gigantic, because an adequate supply of electricity will enable that country’s economy to grow much, much faster. No one has ever attempted to measure some of the harder-to-measure things, to only put money into the very easy-to-measure programmes. There is not nearly enough done in looking at proper cost-benefit analysis across the whole piece. Of course, if you are talking about some of the specific investments we are making alongside the private sector, it is perhaps in some senses easy to measure some of those, because the private sector is trying to measure the effect of the investment.

However, many of the things DFID would do would be more to create the enabling environment for private-sector investment. For example, we are working on a project at the moment to try to tackle the absence of electricity in Nigeria. There is a lot of private-sector investment coming in—indeed, some billions are lined up behind the current privatisation of the industry—but none of that will occur unless tariffs rise to an appropriate level, which in fact they now have, and unless assorted other technical issues to do with gas supply regulation and so forth are fixed, but the returns on that are absolutely gigantic, because an adequate supply of electricity will enable that country’s economy to grow much, much faster. No one has ever attempted to measure some of the harder-to-measure things, to only put money into the very easy-to-measure programmes. There is not nearly enough done in looking at proper cost-benefit analysis across the whole piece. Of course, if you are talking about some of the specific investments we are making alongside the private sector, it is perhaps in some senses easy to measure some of those, because the private sector is trying to measure the effect of the investment.
Q63 Fiona Bruce: A final question, unless you have any thoughts, Owen, is whether we can leverage more private sector funding, other than the ones we have discussed: how can DFID ensure that private sector investment is consistent with its broader policy aims, such as gender equality and environmental sustainability?

Owen Barder: This is at the nub of the question of the respective roles of ODA and DFID in financing private sector investment. It is obviously fantastic news that we have much greater private investment in the developing world, both domestically and externally. The question for us should be, “How can we best use a very small additional resource to help leverage that, but also shape it?” We know, don’t we, that as countries grow, an enormous amount of their growth depends on how unequal they are as a society, and how unequal that growth is. All growth is good, in some sense, but more equal, better-shared growth is better. It reduces poverty faster and it reaches more marginalised groups faster.

I think it is a proper role for DFID to figure out how it can use its very small resources, in the grand scheme of things, to interact with those other private investment projects and programmes, to ensure that people are not left behind in the growth process. Often that means doing some of the things in the background that the private sector will not reach, such as ensuring that projects and programmes reach women and children, and marginalised communities, in lots of different ways. It means finding ways of topping up the private investment to catalyse and shape that change is extremely important.

We talked earlier about development impact bonds, and they are one mechanism to do that, because they turn financially uninvestable propositions into financially investable propositions. You can bring the excitement and the capacity of the private sector to projects that they would not otherwise be able to invest in, because there would not be a sufficient financial return for them. It seems to me that is exactly the kind of role DFID should play. What we should avoid is a situation where we are just trying to do what everyone else is doing—where we are just throwing in our money with everybody else’s private sector investment and saying, “Here is our bit, because we think investment is good and we think growth is good.”

We should be very strictly focusing on reaching particularly those people and those countries that private sector growth will not be reaching any time soon. There are 400 million or 500 million chronically poor people around the world who will simply not benefit from the creation of jobs and the private investment that is going on across the developing world, because they are too far away in lots of different respects from that economic growth. I hope eventually they will, but doing all that we can in the meantime to focus on them—to connect them to the economy, primarily by giving them health, education, access to water, housing and so on—is extremely important if they are to share in economic progress.

Peter Young: I certainly agree with that. I think that our relatively limited resources need to be concentrated on removing the barriers that prevent women and marginalised groups from participating in the growth that will come from the private sector investment. Let me give some specific examples. I mentioned land in Nigeria; we could enable women to participate in the land registration process, so it is not always done by the husband, even though it is the woman who owns the land, and stop inappropriate use of the tax system to harass small women traders, enabling them to build up their businesses more effectively. There is perhaps a role for even unlocking some concessional funds, which exist in the Nigerian Government, to enable some of those small women entrepreneurs to participate in the system.

All those sorts of interventions, which are not of high cost, will have a significant effect. That is the type of thing we should be doing. It is very careful, targeted, quality work.

Q64 Hugh Bayley: Could I, Owen, go back to what you were saying about development bonds? If you were talking about a development bond, shall we say, in Malawi or the DRC, whose credit rating would determine the cost of raising the finance: Malawi’s, or the DRC’s, or the bond issuer, or what?

Owen Barder: The main risk for which the investors would require compensation is the delivery risk. It is the risk that they put money into a scheme to reduce sleeping sickness, and they do not manage to put in place the logistics network, the management network, to get the right vets to deliver the right injections to the cattle at the right time. That is independent of whose finance is standing behind this. That is the majority of the risk that investors are taking, and because they are taking that risk, they are also putting their back into ensuring that that risk does not turn bad on them. They are putting their back into ensuring the right logistics are put in place so that the right cattle are vaccinated.

Then there is a risk that whoever has guaranteed to pay them at the end of it, in the event that the results are achieved, is not creditworthy or walks away from it. In that case, if it is a development impact bond financed by donors, it would be the UK Government,
for example, whose creditworthiness would determine the value they would put on that risk. I would think in today’s market that would be at or very close to gilts, but by far the majority of the return to investors is the delivery risk.

Q65 Hugh Bayley: My observation, following many visits to sub-Saharan Africa—not to Asia, but to sub-Saharan Africa—is that there is a really serious problem with domestic capital accumulation. If you are a multinational company you can obviously finance your new Guinness brewery, or whatever it might be, and there is some effective development assistance, through micro-credit, at a very, very low level, but if you are a garment maker with a sewing machine who wants to employ four other sewers, or to move from being a market trader to opening a shop, or to move from selling paint to making paint, it is almost impossible to raise the capital. What should DFID do better to support the growth of an SME sector in developing countries, and indeed the use of SMEs to deliver development assistance programmes?

Owen Barder: To be honest, I would defer this question to when Chris West is giving evidence. Andrew Rogerson: I think it might be part and parcel of what we are talking about: using the power of a small enterprise, and particularly enterprises that can deliver a social impact, whether that is by employing the people in the paint shop or running ambulance services, or whatever it might be.

Peter Young: As I was saying earlier, it will vary from country to country, but in many countries there are particular barriers that prevent that capital accumulation: the commercial court system does not work, or if it does work, it is for whoever bribes the judge the most; there is no proper land and property title; the regulatory requirements for particular activities are very heavy or it is difficult to get the appropriate licences; some particular aspect of infrastructure does not function; or there are predatory tax inspectors, or whatever. One should attempt to address those things, and that would have a significant effect on the availability of capital in those countries, as it would then become profitable for people to accumulate and lend capital to each other.

Q66 Hugh Bayley: I once asked a parliamentary question to find out what proportion of DFID’s bilateral spend in countries in Africa was spent on buying goods and services from local suppliers, and it was vanishingly small—a fraction of 1%. Whenever you go to a DFID or a World Bank office, it is an office that is wholly provisioned by Western, or maybe Chinese, paint, computers, air conditioning machines and furniture. Everything is shipped in from 5,000 miles away. Wouldn’t it make sense for DFID to set targets for local procurement, even if the paint it got was so terrible that you had to repaint your office every two years instead of every five years? Surely that in itself is generating economic activity and economic development in the country you are intending to help to develop.

Owen Barder: Absolutely. There is a very impressive Canadian organisation that used to be called the Peace Dividend Trust and is now called Building Markets. It was set up by a former Canadian diplomat who, having been responsible for administering Canadian development assistance, concluded that the only time it was any good was when they were procuring local goods and services, and at least helping provide demand for local businesses. He has set up a business connecting, initially, mainly aid agencies and aid donors—the multilaterals and the bilaterals—with local suppliers of everything from bottled water to cars and air conditioners. It is a fantastically inventive and effective intervention.

I was horrified to see the Permanent Secretary of DFID boasting the other day to the Whitehall and Industry Group that 90% of DFID’s centrally procured competitively tendered procurement went to British firms. If a developing country were making that boast, we would accuse them of corruption and ask them to undergo a process of procurement reform. You are absolutely right; it seems to me to be shocking that we buy so little and we have not worked harder to put in place systems to buy locally.

Andrew Rogerson: I think you also need to consider the scale, going forward. Somebody mentioned earlier that the minimum size of DFID operations is rising. The pressures that come, particularly from local staff, if you have to organise 400 construction sites, with artisans working in different districts of a country, are an enormous logistical headache. Even some extremely capable international NGOs find it difficult to meet the requirements of a £10 million, £15 million or £20 million operation for which they are screened.

Peter Young: I know that, having sat on the boards of some of these, I once asked a parliamentary question to find out what proportion of DFID’s bilateral spend in countries in Africa was spent on buying goods and services from local suppliers, and it was vanishingly small—a fraction of 1%. Whenever you go to a DFID or a World Bank office, it is an office that is wholly provisioned by Western, or maybe Chinese, paint, computers, air conditioning machines and furniture. Everything is shipped in from 5,000 miles away. Wouldn’t it make sense for DFID to set targets for local procurement, even if the paint it got was so terrible that you had to repaint your office every two years instead of every five years? Surely that in itself is generating economic activity and economic development in the country you are intending to help to develop.

Owen Barder: Absolutely. There is a very impressive Canadian organisation that used to be called the Peace Dividend Trust and is now called Building Markets.
completely pooh-poohed by the development community, with a few exceptions—in particular, there were honourable exceptions among NGOs—and certainly by the "official" development community. It has taken DFID and one or two others to take the lead, and that involved moving into the kinds of instruments, such as the AECF and other kinds of returnable finance, that we are talking about. I would slightly challenge the assumption that looking at instruments such as concessional finance, particularly if it is done in an innovative way, perhaps along the lines that you have been talking about, is simply following the pack. We tend to think that the current is normal, and therefore things like, as I say, the importance of agriculture, the importance of the private sector, have been taken for granted since the year dot. They have not. They have only been taken for granted in the last three to four years. There is a tendency to kid ourselves, and when we go back 15 years, the situation was completely different. I just wondered if you had any comments on that.

Owen Barder: You are absolutely right. These things tend to move in cycles. There was a long period in the 1990s where infrastructure and economic growth were central, and people shifted away from that. Now people are shifting back to it, and that is excellent. My point about following the pack was less to do with that trend—I actually welcome the focus on economic growth—and more to do with focusing on the special contribution that aid can make that other forms of resource cannot and will not make. It is simply not the case that commercial investors will invest primarily for broader social benefits. Their private investment will deliver broader social benefits, and that is terrific, and there will be many people who get jobs, livelihoods, incomes and access to consumer goods as a result of private investment, and that should be welcomed.

However, there are some people that will not reach, and what the aid system needs to do is keep its eye on the prize of ensuring that everybody shares in that rising prosperity. We should not be sucked into saying, "Now that China and India are doing more infrastructure, we should do more infrastructure." Good example of where concessional resources from the public sector, or certainly non-public sector, finance.

Andrew Rogerson: I absolutely agree, and there is a whole range of financial tools. First of all, yes, on climate change particularly, transfers of technology will not happen without private sector engagement. There has to be a very careful study of what kind of terms can be offered, to the extent that there are sweetnesses to these terms, such as the implicit subsidy involved in the World Bank using its main hard currency window to finance climate change measures. They have to be looked at, as is always the case with public money going to support large-scale private sector, but one has to be incredibly creative or we will not get there. The $100 billion Copenhagen target of additional flows covers the gamut from pure grants, which I think will be a minority, right through to market terms, with perhaps some support in accessing the market in some cases.

Owen Barder: If I may add a footnote to that, this is a good example of the complementarity issue. Almost all the private-sector money going into climate finance is going into mitigation efforts. There is almost no money going into adaptation, and yet for the poorest and most vulnerable countries, adaptation is the most urgent and pressing need. That seems to me a very good example of where concessional resources from the UK could play a role that the private sector does not at the moment seem willing to play.

Andrew Rogerson: Also, this adaptation/mitigation split is important, because if you chose to use public money massively to finance mitigation, that is to say grant or grant-equivalent resources, there will be a huge sucking demand as UK money goes back to China, India, Brazil and possibly Russia, and away from the most fragile country contexts—fragile in every sense of the word.

Peter Young: Again, we need to do what we can to help the countries get the ground rules right, so that private sector investment can flow into these areas. Examples are solar power, which is more viable in Africa than it is in the North of England, and working with countries to make sure that there is an effective...
feed-in tariff, and that the regulatory arrangements allow people to build these facilities and be remunerated from them. That sort of assistance can then create a private market that is financeable.

Owen Barder: Of course the best way to do this is to set a meaningful carbon price and then let the private sector figure out the investment needed to live within it.

Q70 Jeremy Lefroy: The UK is doing that. Do we know how many other countries have done that?

Owen Barder: We have the EU emissions trading scheme, which of course is not working very well and could use some serious overhaul. In the end, if you want the private sector to tackle this problem, there is no better way than setting the carbon price properly.

Q71 Jeremy Lefroy: Are there examples of developing countries that have done that, or middle-income countries setting carbon prices?

Owen Barder: China has an emissions trading scheme between its regions, designed to try to set a carbon price.

Q72 Hugh Bayley: I warmly and strongly support what you wrote on your blog about the relative merits of multilaterals vis-à-vis bilateral aid programmes, but the question I want to ask is: does the UK currently have the right balance between bilateral and multilateral aid, and are the BAR and the MAR effective tools to assess the relative strength of one multilateral versus another, or one country bilateral programme versus another, and to compare whether aid is more effectively spent through multilaterals in general, to set that split between multilateral and bilateral spending ceilings?

Owen Barder: To take your question about the BAR and the MAR first. I think those are tremendous innovations that DFID and the Government should be congratulated on. As Peter was saying, trying to make explicit what the impact is of different projects and programmes and then comparing them and making choices between them based on that seems to me absolutely the right thing to do. I hope this Committee will push DFID to continue to take that approach. It is quite similar to the way that foundations allocate resources. Do not start with how much you want to give each country; start by looking at the list of available projects and programmes and investments, and choose the best ones among them, and then the country allocations are whatever they are. I think that is a very reasonable process to take in the case of the bilateral aid review. Next time round, I would like to see a much more open and transparent process. I think all those offers that country programmes make should be publicly available for scrutiny and for people to comment on and crowd-source a bit before Ministers make decisions about what they want to invest in, so we can all see that that is properly scrutinised process.

Q73 Hugh Bayley: That presupposes that the BAR will be repeated alongside that.

Owen Barder: That is what I am saying. I hope it will be repeated and that, if it is, it is done in an even more open and scrutinisable way. That would be terrific. The multilateral aid review is a more difficult process. It is a big step forward from MOPAN, the previous way for the network to look at the effectiveness of multilaterals, but I think we are still, in that space, hampered by poor data and poor knowledge. It is extraordinary that we cannot answer more precisely the question of how much it typically costs the World Bank or the African Development Bank to build a mile of road, train 1,000 teachers, or buy 1,000 textbooks. It seems to me these are knowable facts. Of course there will be variations between them, just as there are between surgeons’ death rates, but we go ahead and publish those data anyway, and we use that to make informed judgments. We should be doing that in the case of multilaterals.

I hope that DFID will, as a major contributor to these organisations, continue to put a lot of pressure—as it has been doing, to some extent—on making those comparisons more transparent. Ultimately, that is what we mean by effectiveness. The MAR judges organisations on a whole number of things to do with their strategy, their overhead costs, their alignment with our values and so on, but actually what you want to know is how effective this thing is at delivering the results that we are contributing to.

Q74 Hugh Bayley: Briefly, because of a lack of time, it seems to me that there is a methodological gap, in terms of making a logical, transparent assessment about whether you have a 40:60 split or a 60:40 split in working out what proportion of your funding goes to multilateral or bilateral.

Owen Barder: You have pre-empted my next sentence, which is that the BAR/MAR process did not provide any rational basis for the split between multilateral and bilateral aid. I personally think that 40% is too little for the multilateral share. I would like to see that increased. I think the bilateral share should certainly be capped in cash terms. It should have been falling as a share of the aid programme as the aid programme rose. What I think is most demanding of scrutiny is the multibuy part of the aid programme. That is the part of the bilateral programme that is spent through multilateral organisations. That seems to me to be prima facie evidence that we are trying to spend too much bilaterally. What we should be doing is shifting most of that money into the core funding of multilateral organisations, with them using their governance and accountability systems for that money; we should not be scoring it as bilateral aid but putting it through the multilateral system. That is about 20% of our aid, and that seems to me far, far too much. It is well above the OECD average, and I strongly doubt whether that is an effective use of taxpayers’ money. I think we should be shifting that into the core funding of multilaterals.

Peter Young: The problem is that the governance and accountability systems of a number of these multilaterals are not sufficient for us to rely on to pump ever-larger sums of money into them. The BAR and the MAR, while it is great that we are now looking at the effectiveness of organisations that we are providing these funds to, were in fact somewhat overly optimistic in a number of cases, perhaps
because of the way this was structured and the questions asked. If you attempt to look into the details of the performance of some of these multilaterals, the first thing you find is that you cannot actually find the information on any coherent basis. We do not have a bloody clue what the performance is, broadly speaking, of many UN organisations, many EU programmes and so forth, because there is not the information available. As we put in our note, in the case of the UN, for years and years people have been saying, "They do not do baseline studies so you cannot see where the improvement is and what the starting point was; they do not measure outcomes; they only talk about activities." You do not really have much of an idea what on earth is going on. I think a lot of the reason why we are pumping this extra money through the multilaterals is that it is administratively easier to do so, and DFID does not have sufficient administrative budget to handle it itself. It does not make sense that you provide funds to an organisation that is administratively more expensive because you have some kind of cap. Also, if you are trying to spend your budget and you write a cheque to organisation $x$, you have spent the money, even if organisation $x$ does not spend it for another five years, so there are incentives in the system that encourage the spending of money—particularly this extra 20% Owen is talking about—through these multilaterals. I think those incentives should be changed so that the money is counted as spent only when it is spent on the ground, not when it is transferred into the bank account of some multilateral. The administration costs of these multilaterals should be taken into account in the overall assessment of DFID's administration spending, so the incentives operate properly.

Andrew Rogerson: The only part of this last statement that I agree with at all is this last point about more scrutiny on the 20%. That was a point that Owen brought out on multi-bi. I declare an interest: I was on the external scrutiny panel of the bilateral aid review while I was writing the annual reports on multilaterals for the OECD's Development Assistance Committee. I found that there was a very poor fit, in terms of the excellent work done at country level, between the work done at the level of the DFID bilateral programme, and the discussion at the international level about the quality of various institutions. I think Owen will shortly wave one of his in-house products, which deluges you with information and demonstrates—I think conclusively, in the eyes of many academics who look at it—that there are a number of leading multilaterals that perform at least as well as, or better than, DFID. DFID is an outlier; these multilaterals perform far better than the average bilateral. I think we ought to keep that in our head. The feeling that there is a long accountability chain is a real political issue, and I am sure the Committee wrestles with it, but it is part and parcel of an incentive structure where UK NGOs, UK businesses, and people who are interested in the UK bilateral activity are visited, quite rightly, and are seen in DFID's programmes, but the multilaterals do not come into the same kind of contact.

As the UK is only one of 180 member countries—not the least, but not the only one—it is quite difficult to enforce or demand the kind of influence you would normally have on a bilateral programme. I think I would keep the kind of proportions that Owen raised. Of the 60% going through multilaterals—most of which, by the way, goes through AAA-rated multilaterals—only a small part goes to these rather bizarre norm-setting smaller organisations. The 40% could go up safely within the governance structures—warts and all—of those organisations, and within the evaluation requirements they have, which are, in my view, tough. The 20% deserves much closer examination. I do not think that at the country level, when people are deciding, "Okay, we will do this programme with agency $x$, they even check back on what the MAR says about agency $x$. You could ask that question when the case arises, but at one point, when Owen and I were both in DFID, we discovered quite by accident that DFID was giving more money to UNICEF India than DFID as a corporate entity was giving to UNICEF overall—obviously taking out the India proportion of it. Peter Young: Yes, but Andrew, you participated in this MAR/BAR thing, which I had forgotten, and that rated the UNDP, for example, as "good or satisfactory". Anyone who attempts to look at the evaluation reports on that organisation—most of which it does itself—concludes that that is an entirely inappropriate statement. Basically, insofar as you can tell what they are doing, because they do not report on the results, there are all sorts of problems throughout the organisation, in terms of speed, bureaucracy and competence.

Q75 Chair: Unfortunately, I have to stop you. I think you have clearly made your point—a point of disagreement. Please feel free to add to it in writing, but I think we got the message. Our problem is that we have another set of witnesses, and we are going to run out of time. On a related issue, let us say that we do 40% bilateral, which you think should fall, and 40% multilateral, which you think should rise, and the bit in the middle is mixed—is a bilateral purchase of multilateral services. I was interested to hear you imply that we do not have proper supervision of the 20% that we buy, or that it is rather arbitrarily done. What we are really looking at is how DFID could have a better relationship with multilateral delivery, especially in those countries where we do not have bilateral programmes. You are almost implying that we could get rid of DFID and have a small bilateral agency, and that the Treasury should just hand over the money to multilateral agencies and let them get on with it. There is a political problem here of accountability and British national interest. Do you really think The Daily Mail would be satisfied if we said: "We are delivering £8 billion a year to the World Bank, and we have a board member, but the details of what they do is up to them"?

Jeremy Lefroy: I do not think The Financial Times would be satisfied; it is not just The Daily Mail.

Chair: Indeed.
Owen Barder: I was in the position one year of being Britain’s negotiator for the IDA replenishment for the World Bank, where presently this issue arose. One of the things that most struck me was that, around the table, my colleagues from donor nations were mainly from Treasuries. I was the only full-time development professional representing a major donor nation, and it gives Britain an enormous advantage in those negotiations that that is the case, because the British negotiators in that process had a much better insight into the strengths and weaknesses of the World Bank, precisely because they are informed by DFID working on the ground in all these countries. I was able to bring evidence and analysis from our country programmes about things the World Bank was doing well, and things the World Bank was not doing well and to improve. This trend towards having a bilateral network on the ground, managing and delivering aid programmes, and a strong role in the multilateral system is extremely important.

Q76 Chair: That is really helpful. Can I just push another question, while you are answering? I think it would be helpful. In that case, would it be better to have, in addition to what we have, perhaps some slightly stronger regional offices that operate slightly more co-operatively? For example, we are going to Brazil because we have no real presence whatsoever in South America, yet we give money to be spent there. If we had a slightly stronger office that engaged bilaterally with the Bank and the Inter-American Development Bank, would that help inform us and them, and produce a better result?

Owen Barder: No, I do not think the challenge that DFID faces is that it has insufficient intelligence on the ground about how the multilaterals are working. Again, the last thing the world needs is more spread of more bilateral agencies to more countries around the world. There is a trend towards countries concentrating on fewer countries and fewer sectors to increase the efficiency of aid spending, as agreed in the Paris Declaration, and I think we should continue to keep our eyes focused on that.

Peter Young: We need independent evidence. Owen Barder: These are independent. These are three academic—

Peter Young: I am not talking about some vague academic studies.

Owen Barder: They are not vague academic studies.

Peter Young: I am talking about forensic analysis of what is happening on the ground.

Chair: Hang on.

Owen Barder: With respect, Peter, unlike you, we are not paid by DFID. We are independent. That is one data point; there is another, which is what the Finance Ministers of developing countries say. This year, they have again written to the major donors to say, “We would prefer you to put more money through the African Development Bank and the World Bank than to put that money through more and more bilateral aid programmes.” I would have thought, Peter, that you would believe that asking what they want is a good start for understanding what is effective and what is not. If the multilateral agencies were wasting money on staff, overheads and administration, and none of that money was reaching developing countries, then developing countries would scarcely be putting pressure on the donors to put more of their money through the multilateral system and less of their money through the bilateral system. That is what they are asking us to do. They are asking for a good reason.

Q77 Chair: Andrew, you are literally in the middle.

Andrew Rogerson: Yes. On Sir Malcolm’s specific point, I think it is a very good idea to stay very much engaged in parts of the world where bilateral aid has withdrawn, if for no other reason than because many of them are success stories where aid has worked—or perhaps DFID was never there in the first place. As for the specific mechanism of having regional offices, I have my doubts on that, both because of the distance that still remains and, more interestingly, because once you are already outside the governance of organisations like the World Bank with the World Bank’s Executive Director or negotiators, as we have heard, the only other way of getting in touch with country offices, and really understanding what goes on, is if you are a partner in some way. You need some kind of minimal financial stake. You need skin in the game to be credible with other donors and lenders, and you would have to fund this, which DFID did, to its credit, for a while in Latin America and other parts of the world, but then it decided it could no longer afford even regional programmes there, which were a matter of trying to get catalytically injected improvements in the country without an office at a country level.

Chair: That is helpful. The Committee is really teasing out where things are going and what different things might work. As I say, we have another set of witnesses. In conclusion, I think you have all given different views. There is scope for loans; you place
different emphases on what that is, but I think you are all fairly sceptical about the case for having a bank. I hope that is a fair summary. If you feel that, in addition to what you have already said to us, orally and in your submissions, you have anything more to add on how loans might work, what your preference would be, and anything negative—where it would not work and why—that would be helpful. We were going to explore that in a bit more detail, but we have run out of time. I think you have expressed your views and made your positions reasonably clear, but please feel free if, on reflection, you want to follow this up with further details. The Committee genuinely has a very open mind on this. We are teasing out all the options before we come to any definitive conclusion. We are really open to detail. Thank you very much. It has been a really interesting session, and it is always good to have lively disagreement.

Examination of Witnesses

Witnesses: Tamsyn Barton, Director General, European Investment Bank, Marc Engelhardt, Director of Development and Climate, KfW Development Bank, Federal Ministry for Economic Co-operation and Development, and Dr Chris West, Director, Shell Foundation, gave evidence.

Q78 Chair: Thank you very much for coming, and good morning. I am sorry you have been kept waiting, but I think you were listening to the previous debate, so you will have some idea of the context. First of all, may I ask you to introduce yourselves formally for the record? Then we can proceed to giving evidence.

Dr West: Chris West, Director of the Shell Foundation.

Dorothee Fiedler: I am Dorothee Fiedler. I am the Deputy Director General at the German Federal Ministry for Economic Co-operation and Development.

Marc Engelhardt: My name is Marc Engelhardt. I am the Head of the Department for Development and Climate at KfW Development Bank.

Tamsyn Barton: My name is Tamsyn Barton. I am Director General responsible for the European Investment Bank’s lending operations outside the EU.

Q79 Chair: Thank you very much indeed. As I say, you will have heard the flavour of the debate. Our previous witnesses were rather sceptical about the role of a development bank for DFID, but the Committee clearly is keen to explore how other banks operate, and to consider whether or not there is a model that may or may not be appropriate for the UK Government to consider. We very much appreciate that you are willing to share your views and experiences in that direction. We have certainly heard differing views. I think most people have said that some form of loan window is becoming an increasingly necessary part of the mix, and others have said, “Why not a development bank? DFID is a big player, and most other countries have it; why not?” You have heard counter-arguments already this morning.

We know that DFID is considering this situation, and I think it would be helpful perhaps to take the German experience first. You have, of course, a Ministry, and then you have a separate finance arm. How does that work? How do you interact? What are the advantages or disadvantages of being, if you like, in two separate compartments—or how separate are they?

Dorothee Fiedler: Let me thank you, first for inviting me, and then for founding KfW in 1948. We are very grateful to the British for founding this very important institute.

Q80 Chair: We seem to have similar responsibilities for the French bank as well.

Dorothee Fiedler: I think it is very important for me to mention that this is a development bank that has been active for very many years. You may be familiar with the German system: we have those two agencies, GIZ dealing with technical co-operation, and KfW dealing with financial co-operation. We think that with financial co-operation, we can of course broaden our scope of co-operating with third world countries. You may know that the Germans co-operate with about 70 countries all over, so we also include in our programmes the so-called emerging countries—no longer China, but Brazil, India or Mexico, for example. We think that financial co-operation is a very important instrument for co-operation with those countries, because what GIZ does is purely technical co-operation, mainly sending German experts out, but what KfW does is offer a broad range of grants and loans to those countries.

Furthermore, what is very important to us Germans is that the budget part of our grants and loans is more or less stable. It has increased a little, but as a bank with a triple-A rating that is in the ownership of the Federal State and the Federal Government, KfW is very well able to get money from the market. You see a huge increase in the financial co-operation between Germany and a group of developing countries. I think it is about a 14% increase every year for 10 years now. We more or less have the same amount of Government money, but there is a huge increase in the money that KfW has raised. I will leave it at that for the moment.

Marc Engelhardt: If I may add to that, since you asked, Mr Chairman, for the division of labour between the Government body and KfW, the Government clearly sets the political framework. All projects that KfW is financing, either with grants or with concessional loans, are agreed by the German Government with the respective partner Governments in the developing countries. KfW is always acting on behalf of the German Government. The structuring of the lending, the projects and the oversight of the implementation of the project lie in the hands of KfW, so there is a very clear and distinctive division of labour between these two layers.
Q81 Jeremy Lefroy: Thank you very much. Just on a point of fact, what is the total portfolio of KfW in developing countries at the moment, in euros, approximately?
Marc Engelhardt: The ongoing portfolio, you mean?
Jeremy Lefroy: Yes, the current outstanding portfolio.
Marc Engelhardt: It is roughly €20 billion.

Q82 Jeremy Lefroy: Thank you very much. I think in AFD it is something like €16 billion, so I just wanted to get some kind of comparison. We are looking at the possibility that has been raised of the UK establishing a development bank. One alternative that has been suggested is effectively a virtual bank, in the sense that DFID already does some form of what we would call returnable finance. At the moment, it does not get segregated; we personally think it gets lost in the system. It could put all that into one area and then perhaps also do some concessional lending, if it has the legal power to do so. We were told earlier this morning that it does, which I think was a bit of a surprise to some of us. Would you think that the idea of going one step towards a virtual bank within the existing set-up, which would mean that there was the ability to do concessional lending and that there were people there who were experienced in credit risk management and so on, was a sensible way forward, as opposed to setting up a completely new institution?

Dorothee Fiedler: I would not really dare to judge this, but let me just make the point again that in our view, what is really very attractive is that KfW uses more than 60% of its own money, which is an add-up to Government money. We have not only KfW’s money but also the expertise of a bank. The development branch of KfW is just one branch. There is the 1948-founded KfW with all its expertise in development banking—they started in Germany—so we can make very good use of all that. For us Germans, this is very important. A lot of the abilities of GIZ, but particularly that special expertise in banking, and of course the fact that they raise money on the financial markets, is something very special to KfW. That is why we think our system works quite well with a development bank, with its special abilities.

Of course I have to say that the people working at the development branch of KfW are not just banking people. They have different expertise and experience. Many of them are economists, sociologists, or people who have studied politics, but of course the people at the development bank branch of KfW can draw on the experience of their colleagues in the other parts of KfW, so we think that this is an especially good model.

Q83 Jeremy Lefroy: How much of German ODA goes directly to GIZ, and how much goes into KfW?

Dorothee Fiedler: In 2012, to KfW it was—
Marc Engelhardt: €1.5 billion.
Dorothee Fiedler: A little more: €1.8 billion, and for GIZ it should be around €1.3 billion.

Q84 Jeremy Lefroy: Together that makes a fairly small proportion of German ODA, so where does the rest go? German ODA is what—€12 billion to €15 billion in total? It is about 0.5% of GDP.

Dorothee Fiedler: No, it is 0.4% of GDP.

Marc Engelhardt: Correct.

Q85 Jeremy Lefroy: That was one of the questions we were asking JICA in Japan last week, which has a huge development bank portfolio of well over $100 billion, and of course their gross ODA is enormous, but their net ODA is quite small, because of the repayments coming from the loans over many, many years. I wondered how much of an issue this was in Germany. If you have an established development bank that has been going for many years, and then some of those 20-year loans on concessional terms are being repaid and count as negative ODA, how much of a political issue is that? Perhaps on the one side, as we suspect in some countries, raising money on the bond markets through development banks is being used as a way of trying to get towards 0.7% without it affecting the public budget. On the other hand, as we have seen for instance in 2006–07 in DFID, where a major surplus in the Commonwealth Development Corporation reduced the level of ODA substantially, that can become a problem. In other words, if long-term loans are being repaid and new loans are not being given out, there is a negative effect on ODA. I wondered how much of that is a consideration in Germany at this moment.

Dorothee Fiedler: I think this is a problem, yes, and of course with politicians being elected every four years, whoever is in power does not really think about what might happen in the middle or longer term. Of course we are striving very hard to reach the 0.7% goal. We can only congratulate you on already being there, but for us it is still very difficult. I do not think we have really solved that issue. Of course there are ongoing discussions at the OECD, because we think that a bigger part of those loans should be recognised as ODA; the money that can be made by KfW at the market should be accepted as ODA, which it is not right now. To be very frank, I do not have an answer to you on how politicians, in a couple of years, might deal with exactly that problem, which we know we are going to face—that the money will come back. Maybe Marc has another idea.

Marc Engelhardt: As a footnote to that, in the long run, this is clearly a problem if the system stays as it is. For the time being, the German ODA quota is rising, and KfW’s financed share of the ODA is rising. We had an ODA percentage of KfW’s lending activities and grant activities of 6% in 2005, and last year, we had a percentage of 20%, so the rise of German ODA from 0.3% to 0.4%—that is still not sufficient, but it has risen in the past years—was mainly due to the capacity of KfW to augment its share in concessional lending.

Q86 Jeremy Lefroy: Through raising money on the markets?

Marc Engelhardt: Correct.
Q87 Jeremy Lefroy: Which is what the French have done as well.
Marc Engelhardt: Correct.

Q88 Jeremy Lefroy: I have the figures here for German ODA in 2012: it was €10.2 billion. The total you told me for KfW and GIZ is €3.1 billion, so does that mean the German Treasury pays multilateral agencies directly?
Marc Engelhardt: No, because what Dorothee Fiedler was mentioning was the grant part of KfW’s share.

Q89 Jeremy Lefroy: €1.8 billion is grant?
Marc Engelhardt: It is mainly grants and a few soft loans from budget funds. In addition to that, there is another €3.1 billion from KfW’s funds from the capital market—the bonds KfW issues—and a large part of it, roughly 80% of that, merged with grant funds and/or covered by partial risk guarantees from the Government, is accountable as ODA, so the overall ODA that KfW is accountable for is well above €4 billion—€4.5 billion or so.

Q90 Jeremy Lefroy: Or nearly €5 billion, if there is another €3.1 billion on top.
Marc Engelhardt: Yes, as I said, it is not all accountable as ODA. We had total new commitments of €4.9 billion, we are talking about new commitments here, but the disbursements (which are the basis for the ODA calculation), of course, lag behind a bit.

Q91 Jeremy Lefroy: So approximately 20% of Germany’s ODA is through net concessional lending, over and above repayments?
Marc Engelhardt: Yes.

Q92 Fiona Bruce: How can public funding be best used to leverage in private investment? You have heard a lot of the discussion with the previous witnesses.
Marc Engelhardt: First of all, the way development banks—not only KfW, but also the French one and, to a certain degree, EIB and others—function is they issue bonds on the capital market, at least €3.1 billion last year, as I mentioned. Overall in the last 10 years, roughly €20 billion that KfW was spending in addition to Government funds in developing projects for developing countries was raised on the capital market, and so came from the private sector. Private investors who bought those bonds are automatically, if you want, contributing, in a very efficient manner, because they use the system KfW and the German Government have established, to funding development projects. This is one indirect but considerable effect of development banks that people often overlook.

Then of course we have direct ways and means of fostering private sector development. One example is SME funds, which KfW and others have set up in eastern Europe and now in Latin America and other regions. We structure the risks; we collect funds from Governments, from our own funds, and from private investors, to be mixed in one pot but structured so that the private sector takes a lower share of risk, and thereby is attracted in sectors and countries where it normally would not invest.

Q93 Fiona Bruce: So the private sector investment group, you think, is a good model?
Marc Engelhardt: That is also a good example of such ventures, correct.

Q94 Fiona Bruce: My next question is really to all witnesses: how do Governments ensure that private sector investment is consistent with our broader aims of gender equality and environmental sustainability? Dorothee Fiedler: We have very clear rules and regulations, of course, in respect of KfW and GIZ, which are our executing agencies. We also do a similar thing with the multilateral institutions and banks, but mainly with GIZ and KfW we have those very clear rules and regulations. If the private sector is involved in any of our projects, they would have to cling to those same rules and regulations that we have, so we do not finance anything outside of those rules.
Fiona Bruce: Does anyone else want to come in?
Tamsyn Barton: Yes, I can explain a little bit about how it works in the European Investment Bank. We are, of course, owned by the member states of the EU, and every single one of our projects has to be checked by every directorate general in the European Commission, which you will be surprised to know we achieve within two months for each project. Nevertheless, that means in every area of EU standards that have been agreed by member states with the Commission, there are clear safeguards in relation to the areas you mention. On the environment side, I would say that probably we have the toughest standards. Sometimes we find we are not able to co-finance with other development financing institutions because our standards are that much higher, because of our commitment particularly in relation to action to tackle climate change.

As far as social safeguards go, in addition to the policies we have, we also have within the bank specialists, just as KfW does, so we have social and environmental specialists who obviously work closely with other international financing institutions to make sure that we use those standards. We use them partly in our ex-ante estimates of what the results of every project will be. We have a results framework: Peter Young, who was sitting in this place before, seemed to express a lot of doubts about whether such transparent mechanisms exist. Well, they do in the EIB, at least. I was able to introduce a results framework, so it should be pretty clear. We are not able in every case, for example, to get data in relation to gender impact, and I know we can improve in this area, but we have made a start.

Dr West: Just to make a general comment and come back to your specific one, Fiona, if I were to look over the last decade, the transformational change that I think is happening, certainly from our perspective, is that there is a growth in social entrepreneurship—businesses who have, as a mission, a blended social and financial return core to their purpose. That is one transformation of the last decade. I think equally there has been a blending of how the public sector and private sector can co-operate to support these ventures.
Tamsyn Barton, Marc Englehardt, Dorothee Fiedler and Dr Chris West

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Growing, and that has led to impact investment; it has led to an increase in private capital from foundations and others. Possibly misusing Owen’s analogy about the football field at the beginning, where I see the problem at the moment is that you have, if you like, one layer of people who have grant funding to help these enterprises set up and start, and then there is a valley of death before they get into other types of organisation that have a finance-first perspective on life. The real gap we have in this market is how we bridge those two worlds. This is where I find your question about a development bank or other body hugely important. I do not know KfW well enough, but if I were to typify most finance-first organisations as being typically commercial banks, in my experience most development finance institutions are, too. We therefore find a rather unfortunate position: you can catalyse these new, really scalable social entrepreneurs, who are wedded to generating this blend of social and financial value, but they hit this wall where there is no one with the risk appetite, patience and skill support to get them to the level where you can get the balance sheet of, for example, the EIB. My anxiety about the use of concessional finance is that, whether it is cheap money or expensive money, if you do not have a viable partner in which to invest, that money will be wasted. I do not think the issue is the concessionality. The issue is: can you blend together a group of people who can offer the skill support, the appropriate finance, in many different forms, and the market linkages to help this growth sector really emerge, until it gets to the balance sheet position of commercial banks or others? That, for me, is what is missing at the moment. Using Owen’s analogy, I do not think there is a midfield in this football team at the moment. There is a grant-first, development-first sector, and then there is a finance-first sector. What we need is to straddle that. Foundations to some extent are playing that role, but I cannot pass all our successful partners over to someone who will do balance-sheet lending with a finance-first perspective.

Dorothee Fiedler: I would very much like to add to that. One thing that has not been spoken about a lot is the huge difference between a development bank and a bank. KfW is a knowledge bank as well, so they know a lot about what is going on in developing countries. They have very long-standing experience, and they do not just give money; they do not just give grants or loans. It is the other way around: they know a lot about developing countries and developing policy; they have a lot of experience. For example, right now the World Bank is saying, “We want to be seen as a knowledge institution.” The countries we are co-operating with, even the bigger ones, say, “Okay, what we want from KfW is not just their money. We get money at many different banks. We want that special expertise that you can offer.” They do it either by themselves or through people they hire, but that is what we really like very much about the idea of having a development bank, and not just a bank that gives out grants or loans.

Marc Englehardt: That is really a big advantage of a development bank, because you have the holistic assessment of a project; you have the banking perspective, the development perspective, the real financial risk, but also the reputational risk in one institution, at least. We also have a credit risk department, which tends to set pretty hard standards. We have an environmental department, which is as hard, probably, as the one at EIB, but we have the whole assessment and the whole risk burden, in the end, in one institution. That helps a lot. Coming back to the knowledge point of view, that may be another argument for a bilateral bank. You will not be surprised that I am in favour of a bilateral bank, because you have a specific knowledge in each country. That is, you have real value added. Some multilaterals surely have good projects, and of course there are a lot of good arguments for having multilateral banks and multilateral agencies, but especially higher developed countries ask for specific knowledge and value added, and you can better combine that with the knowledge you have from your own country, because we have it at first hand.

Tamsyn Barton: Could I also pick up this missing midfield point? It does seem to be pretty critical. It is the job of DFIs to fill that role. KfW is a knowledge bank as well, so they do it either by themselves or through people they hire, but that is what we really like very much about the idea of having a development bank, and not just a bank that gives out grants or loans. It is the other way around: they know a lot about developing countries and developing policy; they have a lot of experience. For example, right now the World Bank is saying, “We want to be seen as a knowledge institution.” The countries we are co-operating with, even the bigger ones, say, “Okay, what we want from KfW is not just their money. We get money at many different banks. We want that special expertise that you can offer.” They do it either by themselves or through people they hire, but that is what we really like very much about the idea of having a development bank, and not just a bank that gives out grants or loans.

Q95 Jeremy Lefroy: Following up on what Tamsyn and Chris were saying, the biggest problem with regard to the middle, which is still a massive problem, seems to be the transaction cost, which basically means the cost of the people. It is often highly paid, developed country people doing the job. How do you see us being able to overcome that? To me, it is a major problem, and often I have seen people saying, “We would love to do this, but the transaction cost is too high.” In effect, you have a perfectly good thing that is sunk because it is costing too much in terms of highly paid people. How do we get round that? There must be ways to get round it. Obviously, volunteers can overcome that, or training people locally, where the costs are perhaps lower, to do all that kind of professional work.

The second thing is the tools available. They seem to be either grant or loan, and there is always a
problem—Chris will know a lot about this—with equity-type tools in small businesses, particularly where the governance structure is not set up so that equity makes much sense. How do we get around that? Again, it seems to me that a lot of very good SME-type projects are simply not financed in developing countries because of the question of the lack of an equity-based tool, or the cost. How would a development bank fit into that, or how could something that DFID could do fit into that?

Dr West: For this market segment, if I look at social enterprises growing, to get through that midlevel one has to accept that whatever products and services they need, they need skilled support, and they need finance in the right form, which therefore means the transaction cost of servicing that market is high and the risk is high. That is why the end result is a lower yielding return out of investing in that. It is a combination of both cost and risk. Now, there might be smarter ways of doing it, but I think fundamentally that is why you need a bridging instrument beyond the finance first, which will try to reduce cost and therefore reduce risk, and therefore invest in things with a slight more social return expectation. If we do not have a higher-transactional-cost, risk-tolerant vehicle in the middle, I do not think you will get the graduation of these initiatives to the scale we all hope for.

On your second point about the range of instruments, again, there is a lot of liquidity in a lot of emerging economies, as was alluded to in the last conversation. A lot of that is locked up in banks that have hugely conservative lending rates, and of course it is often provided in short-term debt. If you are a start-up growing business in any country in the world, you really need some form of patient, flexible finance that adjusts to your cash flow income. It is not necessarily a short-term debt instrument. Equity is usually not very attractive to the entrepreneur, and it is also not necessarily attractive to the investor, because there is not a very clear exit route from investing in equity in small ventures like this.

You really need different finance forms. You need mezzanine finance forms related to the cash flow performance of the business that are much more patient and much more flexible in tenor. Again, they are not difficult to construct, but I think fundamentally that is why you need a bridging instrument beyond the finance first, which will try to reduce cost and therefore reduce risk, and therefore invest in things with a slight more social return expectation. If we do not have a higher-transactional-cost, risk-tolerant vehicle in the middle, I do not think you will get the graduation of these initiatives to the scale we all hope for.

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On your second point about the range of instruments, again, there is a lot of liquidity in a lot of emerging economies, as was alluded to in the last conversation. A lot of that is locked up in banks that have hugely conservative lending rates, and of course it is often provided in short-term debt. If you are a start-up growing business in any country in the world, you really need some form of patient, flexible finance that adjusts to your cash flow income. It is not necessarily a short-term debt instrument. Equity is usually not very attractive to the entrepreneur, and it is also not necessarily attractive to the investor, because there is not a very clear exit route from investing in equity in small ventures like this.

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Q97 Jeremy Lefroy: This is the point we made to CDC when we did the report: people would be very willing to come and work for an organisation like CDC without looking for City of London salaries.

Marc Engelhardt: There is exactly that point. I have one other point: in the session before, you were referring to the local structure. KfW increased its local structure tremendously over the past 10 years. We meanwhile have 80 offices abroad, but with only 80 to 100 permanent staff from Frankfurt, plus another 300 local staff. Per office, it costs us roughly only €300,000 to €400,000 per year. The reason for that is not so much that we use local furniture, as you were referring to before; it is because we have a very lean structure. We have normally one German or international representative—sometimes two in the bigger countries—and then four to five, sometimes 10, highly qualified local staff, who are also not cheap but are, of course, far less expensive than international experts. We can thereby afford a very powerful and important structure for our quality assurance that is not that costly.

Dorothee Fiedler: Yes, I would like to underline that. I spoke about the German system with KfW and GIZ. We have people going to both sides, so people who have worked with GIZ now work with KfW and the other way around. As Marc said, in both institutions we do increasingly employ highly qualified staff in those countries. In more or less all of Latin America, you sometimes get better qualified people from those countries than from our own country. I would still say that the people—be they from KfW or GIZ in Germany, or from those countries—are cheaper than the experts from the big development banks, the World Bank and other banks. We think this is a very important point.

The other thing is that we do a lot in human resource development in the field of technical co-operation. The people that we do the training for in technical co-operation could then be used in the field of financial co-operation, which is KfW. This makes a lot of sense, and with your DFID experience, knowledge, structure, and whatever, you will already have a lot of things that you have also done in human resource development, so you could very easily find well qualified people in the countries you are co-operating with.

Q98 Hugh Bayley: My first question is to Marc and Tamsyn. What proportion of your loan book is accounted for by loans to least developed countries, and what proportion to EU accession states, past or present—that is to say, countries that have recently joined the EU, or states, like Turkey, that are in the course of negotiations.

Tamsyn Barton: I cannot give you the figures now; I will get it for you. I can tell you about last year: last year, our lending side outside the EU was €7.4 billion, and €4 billion of that was non-accession, so it is a substantial proportion.

Q99 Hugh Bayley: Outside the EU was €7.4 billion, of which €4 billion was non-accession. So getting on for half is accession.

Tamsyn Barton: That is indeed how it is at the moment. Croatia, of course, acceded yesterday, and that was one of the more significant countries, but Turkey is indeed the largest, in terms of annual lending. That is what we do as our mandate, but the cost is far less in relation to lending in Turkey—both the internal cost and the use of public funds is much less, so outside the ACP, where we have the European Development Fund, we just operate on the basis of a guarantee from the EU budget. We do not use it in relation to the private sector, except for political risk, and at least half of our lending in Turkey does not involve any public money at all.

Q100 Hugh Bayley: And for KfW?

Marc Engelhardt: I do not have the absolute exact figures, but when it comes to the accession and pre-accession countries, it is less than 10% of the new commitments and also the overall portfolio. We still have a portfolio in Turkey, and a little bit in Romania, Bulgaria and Croatia, but all in all, this is far less than 10% of our portfolio. As for the LDC portfolio, all in all, new commitments to LDCs—concessional loans and grants—is approx 20%. What is interesting is that this already used to be the overall figure 10 years ago, when we operated almost exclusively with Government funds. 20% went to LDCs. Meanwhile, nearly 50% of the Government funds go to LDCs; because we can use those funds in MICs much more efficiently. We use much less Government funds for MICs and higher-developed countries.

Q101 Hugh Bayley: If you think back to the time, 10 or 15 years ago, when there was wide-scale multilateral and bilateral debt relief, what proportion of your respective portfolios did you write down or write off? Perhaps I should add, I think for both banks but particularly for the EIB, what impact has the eurozone crisis had on the value of investment? For instance, have you had to write down or write off historical investments in Greece? The first is a more general question about the debt relief exercise 10 or 15 years ago.

Tamsyn Barton: Again, I will have to go back and check out the figures for you, but we are fully implicated in all the debt relief for HIPCs. It is not always straightforward to pay it off. We have just had to provide €50 million to Ghana in relation to debt relief, which went straight into a Millennium Development Goal contract. There was a little wrinkle, which was that we had not dealt with the refinances from the Lomé Convention, but while I was in DFID I managed to sort that one out so that they also went back to the countries from which they came, because it was not initially involved in the first cut of
debt relief. I am not aware of an instance where we did not fully conform to what other multilaterals were doing.

Q 102 Hugh Bayley: It is not so much about whether you conformed. I am just trying to think about what would happen if we were to set up some UK instrument for a loan window, whether within DFID or within a separate institution. Thinking over a 25 or 30-year period, if that is the course of the loans, we ought to have an idea of how many loans inadvertently turn into grants, because inevitably you make bad investment decisions. That is the nature of it.

Tamsyn Barton: That is a very different thing. The organised debt relief is not at all the same as losses taken in the course of normal business.

Q 103 Hugh Bayley: Is it not conceptually the same thing, just dealt with in a different way?

Tamsyn Barton: That would be a very, very problematic line to cross. What is crucial to all of us MDBs is that we have preferred creditor status, so we will be paid back. That is the only way we can operate. To answer your question, now I understand what you are getting at, if you take the use of the guarantee from the EU budget for our external lending, since the 1980s there have only been three cases where we have had to use it: Argentina, the former Yugoslavia, and, most recently, Syria. Syria is obviously ongoing, but with Argentina and Yugoslavia we got all the money back, and at a very decent rate of interest, by today’s standards.

Hugh Bayley: Today’s standards—oh, yes.

Tamsyn Barton: It is a benefit, ultimately, to the grants available for ODA, so member states have not lost any money in that way.

In relation to the investment facility, as I mentioned, it is ring-fenced, and it does take a bit more risk within the limits of the risk parameters. In more risky countries, such as Zimbabwe and Côte d’Ivoire, we did have some losses, but we generally recover them over time. We also have complications when there is political conditionality or sanctions imposed, as in Syria. We get the money back, but we obviously lose the leverage and still have to give the political conditionality.

Marc Engelhardt: At KfW, we were not affected that much by the huge debt rescheduling in the HIPC countries in the late 1990s, because back then we operated almost exclusively with grants or very soft loans that were restructured. In the last 10 years, when we really started concessional lending with market loans, I recall only one case where we had a write-off: in Central Asia in 2009, we had to write off, for that fiscal year, approx. €50 million, but we regained a good part of it the next year due to a restructuring exercise, so there were net losses of maybe €20 million or €30 million but over a period of 10 years, with market funds amounting to €20 billion, so this is a very low rate of losses.

Q 104 Hugh Bayley: There are two conceptual questions that it would be very interesting to hear about, if either of you were able to think about them and send us a further note or evidence. If you create a loan instrument, as you have done over the last decade, does that skew your partnerships more towards low-income and middle-income countries, rather than least developed countries, and, if so, to what proportion? That would give us a little bit of a guide as to what the implications of unlocking this Pandora’s box would be.

Secondly, there is a question over what proportion of your overall portfolio turns out to be a bad investment and is, in effect, written off. It sounds like, from both of your cases, you can manage things so that it is a very small proportion, but I would be interested to know. If DFID were to create a loan window, would it make it easier, Marc, for KfW and DFID to join together in a joint venture on a scheme?

Marc Engelhardt: It would open new opportunities. As a matter of fact, we are already co-operating on a number of projects, together with DFID. I have heard that this is functioning pretty well, but, of course, it would open new perspectives. One model could be a model established by the EIB, AFD and KfW, and formally launched this year, which is the Mutual Reliance Initiative, where these three development banks are connected with each other’s procedures, one could open up new forms of co-financing, because then one takes the lead and the others do not have to double the effort, so you really have efficiency gains. The procedures are pretty elaborate. We have a 50-page document with all these procedures laid out, so it is not just a political-lip-service document; it is a really matter-of-fact co-ordinating of nitty-gritties and nuts and bolts. That is why it is functioning, in our opinion. If DFID were willing and able to follow those procedures, one could open up new forms of co-operation, or venture into new projects together with DFID.

The other window, somehow linked also to the Mutual Reliance Initiative, is EU blending. As you probably know, the European Commission is planning to enhance the part of EU grants blended to loans from development banks, with the same interest I reckon the German Government had 10 years ago, to increase the leverage and still be able to use the budget in a more efficient way. This is happening on a large scale, projected for the next seven-year cycle of the European Commission. There, of course, DFID would be a highly welcome partner, as an additional European development bank in that circle.

Tamsyn Barton: Could I pick up your point on skewing and your worry about skewing? I would say it is the opposite. There is a new opportunity to make sure that scarce grant funds are not used for the wrong projects or the wrong countries. I certainly can see that, within the context of the European Commission’s funds, they have been able to focus a bit more on low-income countries. They know that, in effect, they can ensure that there is not a gap left; because there can be an increasing move into more lending, or blending where loans are the larger part. I would not say it is skewing. It can achieve different goals with different instruments. One of the key things that we do for the EU is in relation to the BRIC countries, for example. There is clearly a mutual interest in climate
mitigation, and those are the countries with the biggest emissions. If we can bring the expertise from Europe with the latest technologies to bear, that is probably the most useful use of those funds that you could find for that goal. You need to determine what your priority goals are.

Q105 Hugh Bayley: That is the point. If you want to do middle-income countries, set up a more appropriate mechanism. If you want to remain a DFID niche for the poorest countries, then probably you do not need this additional instrument.

Tamsyn Barton: It is partly about countries. It is also about projects, because even in poorer countries, you can really only get the scale of investment in terms of a loan, and it is a more appropriate use of the scarce grants just to blend, for example, for the project feasibility work, without which it would not happen. So it should end up being more effective, and, again, if DFID were involved in both grants and loans, it might be better able to determine, in the context of what it does multilaterally, where the best uses are.

Q106 Hugh Bayley: Chris, you said some time back that DFID is lacking business DNA. Is that still the case?

Dr West: Let me first define what I mean by “business DNA”: how to assess and take risk; to look at a market opportunity and provide the best form of product or service to satisfy that; and to look at it in a way that you escape subsidy dependence and create something that can stand on its own two feet. This goes back to Jeremy’s point. Clearly, DFID has evolved in the last decade or 15 years in many ways. The whole world has evolved in terms of how it wants to cooperate between the public sector and the private sector. Going back to the point about the bank, I am very loth to recommend ever setting up a new institution when you do not look at whether the existing institutions can do what is needed, but I would say that there is a gap here. As I see it, and given the market I am supporting, the present institutional landscape or framework is not sufficient to allow these social enterprises to go to scale. Despite what everyone might say, there is a gap.

Then I look at what the instruments are, in a UK context, that could help there. If I look at CDC, it has had a private equity focus in the past, although it is admittedly getting into loans now. The risk appetite and the return appetite from that is simply not adequate to address this gap. We need impact funds. DFID has very generously put an impact fund through DFID equally has the Business Innovation Facility, of which I chair the selection committee. Again, it is extremely good at taking risk and outsourcing it to a consultant to manage. It is really bringing in the private sector to do things that it would not normally have done. Excellent. But it is outsourced to a consultant. It is not really part of DFID.

Then I start thinking, “Is there anything in the UK system at the moment that I can take our partners to that operates that bridging support of skill support, appropriately structured finance, and ways of leveraging in others, like KfW?” and that does not exist. It is not just the UK. From my angle, there is not one, whether it find it in Nairobi or whether I find it in Brazil. These entities are few and far between. Maybe I should get to know KfW more, because the idea of someone playing a proponent role, developing deals to the point where they are financeable, is what is needed.

If we go back to the pre-accession days in the European Union, what was the real problem in pre-accession? It was not the fact that there was not money available, but that we needed to develop deals that could be bankable to secure that money under the various programmes at the time. We have the exact same problem in the development space at the moment. We need a project preparation facility, coupled with finance that will take a lower-yielding, marginal return on those deals, and leverage off that, and then bridge into other types of finance, which are amply developed. Business DNA, moulded with development DNA, is what this entity needs to have. It is those two sets of DNA. At the moment, we have got one that is development DNA—grant-based—and financial DNA. That is how we have to mix that up.

I am just worried about a model that is outsourced to a consultant, not because consultants are not great, but because you want a manager with an incentive framework that is judged on how he or she delivers outcomes from such a vehicle. Consultants are often judged by whether they have met various input targets. This is why I feel you need a mechanism that somebody is incentivised to make things work. Part of that incentive framework then captures the things that Fiona was talking about: can you generate sufficient measurable, audit-able social value, as well as financial value? Can you leverage in capital from others? To me, that is a much more interesting structural route than the routes we have at the moment in the UK.

Q107 Hugh Bayley: I would like to go back, if I may, to the German experience. Dorothee, it is clear to me that this move towards using KfW increasingly to provide loan finance is something that has happened over the last decade or so. What have been the considerations within your Ministry, in terms of German Government policy, that underpin this? In other words, has the policy be formulated by the German Government policy, that underpin this?
Government and by Ministers, and a brief passed to KfW, or has it happened without a direct policy initiative being taken by the Government?

Dorothee Fiedler: This is the way we share our work between the Government and KfW. That means there was a general agreement between the Government and KfW, which has been in existence more or less ever since. Then we have guidelines for financial and technical co-operation, which have been very clearly set by the Ministry; of course, that is in discussion with KfW, but they have been set by the Government. Then there is a contract letter for each and every single project we have. What we are doing, and what we do increasingly, is really the policy governance of our financial and technical co-operation very much jointly with the organisations, but it is most definitely the Ministry’s task to set those guidelines for, for example, financial co-operation.

Q108 Hugh Bayley: Why did the Government decide that Germany should increase the proportion of its ODA that took the form of loans?

Dorothee Fiedler: Because we had the impression of its ODA that took the form of loans? The Ministry was about 50 years old now, and you may remember, more or less, what the development world was at that time. Of course, it was mainly grants, and I think a lot of KfW’s money goes into climate programmes, as well as social infrastructure. This a very, very poor than we are. I happen to know a bit about Latin America than about other parts of the world. If you look into those huge social programmes that Brazil and Mexico, for example, do, they do it very well. We could not really assist them, but we co-operate with them in other fields. If you want, we give some of those countries just leeway. We leave their budgetary money really to co-operate directly with the poor in those countries. We have the impression in many of those more emerging countries that, in a way, it becomes increasingly difficult for us to assist with the fighting of poverty, and we think that we should concentrate on other fields where we think that we are better able to do it. Of course, this is different in other countries. As I said, a lot are sub-Saharan African countries, where we still concentrate very much on direct poverty reduction. However, in those more advanced countries, we increasingly get out of those programmes and get into other programmes. If you look at the portfolio of KfW, I think a lot of KfW’s money goes into climate programmes, water programmes, and infrastructure programmes, as well as social infrastructure. This is a bit different from what you do to immediately work for the poor.

Q109 Chair: Just perhaps drawing the threads together, you see from the previous witnesses, and indeed the overall structure of DFID, that the UK has concentrated on trying to reach the poorest people in the poorest countries. In that context, grants have been the vehicle for doing it. As the world changes, people’s incomes are rising and the number of very poor countries is thankfully falling, although we have a debate about where you make the cut-off point. Is a country that has $2,500 per-capita income a rich country? If I do not think that many people would think it was, so we could have a debate about that. What I am interested in is the extent to which you feel your operation—the loan operation, the banking and financial operation—helps to lift people out of poverty, whether they are in the poorest countries or in emerging economies. If I give you the example of India, which we have talked about before, the UK has decided that the grant-aid approach to India is no longer appropriate, but we are potentially walking away from 400 million people living absolutely at the poverty level. A lot of what you do goes to middle-income countries and into projects that are much closer to the market. We are interested in the extent to which, if DFID was to go down this route, it could add value to DFID’s very sharp focus on poverty reduction, whether it is the poorest people in emerging economies or the poorest people in the poorest countries. Do you feel that you can achieve that in the way you operate, and do you think that there is a model that would enable DFID to achieve that?

Dorothee Fiedler: There is still a very strong focus on the poorest in German development policy, as well. However, we feel that in those more emerging countries, the countries themselves very often are even better able to do something directly for their very, very poor than we are. I happen to know a bit more about Latin America than about other parts of the world. If you look into those huge social programmes that Brazil and Mexico, for example, do, they do it very well. We could not really assist them, but we co-operate with them in other fields. If you want, we give some of those countries just leeway. We leave their budgetary money really to co-operate directly with the poor in those countries. We have the impression in many of those more emerging countries that, in a way, it becomes increasingly difficult for us to assist with the fighting of poverty, and we think that we should concentrate on other fields where we think that we are better able to do it. Of course, this is different in other countries. As I said, a lot are sub-Saharan African countries, where we still concentrate very much on direct poverty reduction. However, in those more advanced countries, we increasingly get out of those programmes and get into other programmes. If you look at the portfolio of KfW, I think a lot of KfW’s money goes into climate programmes, water programmes, and infrastructure programmes, as well as social infrastructure. This is a bit different from what you do to immediately work for the poor.

Q110 Chair: What about the EIB?

Tamsyn Barton: You have heard a lot from other witnesses about how the landscape is changing, and I think a lot of people have been given pause for thought by looking at what happened in terms of the MDGs, where the major numbers lifted out of poverty were in China, and that was obviously an export-led route and an indirect route. More and more in the development landscape we are thinking, “How can we be part of a much larger-scale, transformational effort with smaller amounts of money?” It is often harder to show what our grants have achieved beyond a very short-term, direct impact, and I think that, given DFID’s strength up to now in being an all-rounder, it needs to be, in some sense, present at both ends to understand where the most difference can be made,
and to use that knowledge in policy in relation to the multilaterals and what it does more generally. In EIB we do some direct poverty lending with much higher levels of grants—water projects, for example, or micro-finance investments—but the bulk is on the indirect side, and that is all very clearly set out in the way that, for each project, we anticipate what the results will be, how we are going to get there, and what the specific EIB addition to the project is.

Q111 Chair: Do you both lend to the public and private sectors?
Tamsyn Barton: We certainly do, and obviously are involved a lot, for example, in support to PPPs, which were raised earlier, where we have specialist expertise.
Marc Englehardt: We lend mainly to the public sector, but sometimes we can also lend, via financial intermediaries, to the private sector. By the way, we also support social entrepreneurs in India, so that is also possible if you have an intermediary. There may be one footnote that may help: you have to differentiate between lending and on-lending conditions. The lending conditions to MICS, to a country like India or Brazil, should be more than a grant, but then of course, if, for example, you have a water sanitation project, you can formulate on-lending requirements for remote areas or small municipalities that are very favourable, or even grant-based, and for bigger or richer municipalities, you have perhaps one-to-one on-lending conditions, so there you can play to get tailor-made financing, not only for the country but also for the end purpose of the project, and differentiate it according to financial strength as well as performance. We had projects where we linked the on-lending conditions also to the performance of the municipalities, which proved to be a good instrument.

Q112 Jeremy Lefroy: First, I am thinking particularly of a KfW project that I saw over many years, involving rural water supply in northern Tanzania, which seemed to me to be a particularly effective project. One of the advantages was that it was a long-term project over many years—perhaps 10 or more. Do you think that there is a restriction in the kind of time scale over which DFID is able to interact, because it does not have a loan window and is constrained effectively by four-year spending periods? We may have reached 0.7%, but no Government is bound by its predecessor, and therefore the next Government could cut aid spending drastically, and therefore aid programmes only really have a time window, at the moment, up to 2015. You could not undertake directly a project such as the one that KfW did, although you could do it through a multilateral. That is my first question: do you think that there is an advantage in the ability to deal with long-term projects in countries, perhaps, where the multilaterals are not particularly engaged? We have to admit that they are not engaged in every single country, much as we would like them to be.

The second question is really focused on what Chris was saying. From my own experience—obviously I declare the usual interest, having been involved in this area for many years—I would absolutely endorse what Chris was saying about the inability to get all the kind of finance and all the kind of legal stuff available in one place, to work with small social enterprises or small and medium companies. It is hugely time-consuming to do that, and I wondered, Chris, if you saw that as an area that a development bank or a virtual development bank, or some kind of financial institution within DFID, could make a core competence, since it does not seem to exist anywhere else.

Dorothee Fiedler: I really think it is a big advantage that we have longer time frames for our projects. Even though politicians may only be elected for four years, we make commitments that go very far beyond that. For example, with KfW, we might plan a project that extends much further than those four years. We also have the advantage that technical co-operation via GIZ may come into that same project, which even makes it a little longer, so that after KfW has left, after maybe eight years, you may still have a part of technical co-operation that goes on and helps make sure that the results are really very good. I think our instruments are good.

Every two years, we have inter-governmental negotiations, and then we commit ourselves to projects, but those projects do not necessarily have to last for four years, or even less; they could go for much longer. Sometimes, we have a preparation period, which goes for maybe two years, and only then will it start. So this is one of the advantages, maybe, of our system: whoever is the Government, those commitments are for a much longer term, in both financial and technical co-operation.

Marc Englehardt: What helps, also, is the attitude of the development bank. It does not take too long. Coming back to what Ms Bruce asked earlier, about whether we need more time, I think that, yes, sometime we need more time, and definitely more than four years. On the other hand, we should not wait for ages, and the attitude of the development bank that has to see results, after a certain time, and also the attitude of the recipient country that has to repay the loan—and has to pay, in most cases, or at least in our case, a commitment fee—can also speed up some processes. This has to do with the ownership issue mentioned earlier, so there a development-banking perspective may help to make things happen, at least after 10 years, and not after 20 or 30 years.

Dr West: From my side, I have the fortune of probably having some of the highest-risk capital under management around, through a foundation. However, having said that, investing in these and catalysing and creating some of these ventures has taken us a huge length of time. We are still partnering with some after 10 years. Patience is the name of the game here. It is right that those with the high-risk, early-stage capital play that patience, longer-term game. The question then is about who then takes them on. To answer your question, if you look in Africa, as an example of one region at the moment, most job creation is going to come through the SME sector. Of that SME sector, it will particularly be the “S”—the small enterprise. It is completely unbanked and unserviced.
Over a decade ago, we co-founded a partner, GroFin, that specialised in providing the skills and finance for that. It is doing well, and has now raised $170 million from various organisations around the world, including the EIB. It is doing it in a way that is financially viable, with measurable social outcomes. We are now at a point where the marginal returns from that business mean the credit committees at some of the DFIs are writing it off. There we have a dichotomy, where we need an intermediary of some sort that can provide some degree of subsidy to this, but equally accept the marginal returns of doing this high-cost, high-risk business, to create the jobs in Africa that we all know are needed. It does not lend itself, as a vehicle, to balance-sheet lending from a DFI. It does not have private-equity-type returns. It does not lend itself to a commercial bank that does debt finance, so we struggle where something has been nurtured and is doing really, really well, and many of the people that we had to go to, to raise the capital to support it, do not accept the levels of returns from it. That is the tragedy of this space: that we cannot then bridge it. That is not in any way to say that those institutions not accepting that level of risk are not right. It is just that they are fit for a different purpose than taking these social entrepreneurs through that bridging phase. That is what we really need: someone who can do that now. Whether DFID can do it, or whether it can help co-create others like this or support the few that do exist, I think it is absolutely the right thing for a subsidy provider to be asking itself.

**Tamsyn Barton:** I would really like to come in on this point about the long term, because it is a very important part of the decision-making. The EIB was set up for the purpose of financing regional infrastructure to join up the European community. We take that beyond the EU, in what we do outside and to support to regional infrastructure, generally and particularly. We can lend, in exceptional cases, for up to 50 years. Obviously, there is a huge mismatch between the speed at which development really happens and the normal donor habit of doing three-year projects, and that is a real problem. It is striking, whether it is in NGOs or in any grant-making sector, that the interest in the evaluations dies off somewhat quickly after the end of the project. All the interest is in the design stage, so certainly that is a mismatch.

However, the difficult issue for DFID, if it does go into this, is that it is a commitment for 20 years, or more if it takes longer to get something off the ground. You were asking about the write-offs that we have. Most of the write-offs that we have are ancient heritage—pre-Lomé portfolio from the 1980s and 1990s—and come back to haunt us many years later because of political changes or new risks. There is an awful lot of monitoring work to do for 20 years, whereas with a grant, normally, the file can be pretty much closed apart from for the evaluators, so the administrative costs of this are high, but it is a huge gap in the market. Everywhere we go, we are able, for example, to increase the terms at which the banking sector can lend, because they can only lend short-term.

**Chair:** I think that is really what we are teasing out: does DFID stick to what it knows, or does it help to fill a gap between where the multilaterals are operating comfortably and simply giving grants? I completely accept the point. I think we have found both these sessions extremely interesting. They are confusing in a way, because they are contradictory, but that is fair enough. We are really trying to tease these things out, and I think we are quite a long way from settling on what we would choose to recommend, but then we have quite a little while to go on this. We have had interesting informal sessions, just to share this with you. For example, we had JICA last week, which was a very interesting session; we also had a session with the president of the World Bank. Other donors and multilaterals have said that they believe that if DFID had a little bit more flexibility, then the scope for productive co-operation between DFID and other agencies might expand. That is one area that perhaps we need to tease out: the extent to which that would or would not happen, and what mechanisms we need for it.

Can I thank you very much? It has been really interesting for us to hear how these things operate in other spheres, and also your thoughts about what DFID should be focusing on. Thank you very much indeed.
Tuesday 3 September 2013

Members present:

Sir Malcolm Bruce (Chair)

Hugh Bayley
Fiona Bruce
Pauline Latham
Jeremy Lefroy

Michael McCann
Fiona O’Donnell
Chris White

Examination of Witnesses

Witnesses: Simon Howarth, Technical Director, Mott MacDonald, Philip Schluter, Managing Director, Schluter Ltd, and Caroline Ashley, Director, Ashley Insight Ltd, gave evidence.

Q113 Chair Good morning and welcome, and can I give you a bit of a warning? Because this is a rather short session of Parliament. Members are somewhat divided in their loyalties, so we are somewhat pressed for time and people will be coming and going. We do want to hear from you, but please can we try to keep it crisp, so that we can get to all the things we would like to discuss? First of all, thank you very much for coming in, and perhaps you could first introduce yourselves, just for the record.

Philip Schluter: My name is Philip Schluter. I now own and run a family business called Schluter Ltd. We were founded in 1858. We are coffee traders, working exclusively in sourcing coffees in Africa, and we have a worldwide market that we supply into.

Caroline Ashley: My name is Caroline Ashley, from Ashley Insight. I work on a number of donor-funded projects and programmes that engage with the private sector.

Simon Howarth: I am Simon Howarth, Technical Director in the International Development Division of Mott MacDonald, which is a large consulting firm.

Q114 Chair Thank you very much. The context of this is an inquiry into the changing role of development agencies, and particularly interaction with the private sector, perhaps the possibility of moving away from purely grants to loans, both to the public and the private sector. You obviously are all engaged in the private sector, so that is what we are wanting to explore. You have just done it very briefly in your summary, so perhaps if I ask you to incorporate what you do into the next question, it might get us moving along more quickly.

The question really is: how do you think the Department for International Development could best promote private business and interact with organisations like yourselves? Should they focus on any particular types of business, or is there just a generic, “We can promote private business and its mechanisms”, or is it sectoral targets? Perhaps we can work on that. Who wants to go with that first?

Philip Schluter: I will happily go first. I think I have submitted something short and written. From where I sit, I am a very small player in a very large field. One of the frustrations we find, and I think people in our sector find, is accessing appropriate levels of funding which are often relatively small amounts, both for investment in infrastructure but also for working capital. Most of our supply chain are small operators, exporters around the East African and West African zones, and their biggest need is access to small amounts—$10,000, $20,000, up to $50,000 working capital loans, which are almost impossible to access in the current environment.

Q115 Chair That raises a good point. Is DFID capable of doing that, or would it be better for them to find companies like yours with whom they can work? How would it better be done?

Philip Schluter: It is quite easily done if you have very clear criteria for how funding is meant to be used, and a clear reporting mechanism. You could then lend it to companies like ours, who are doing it already and would very happily give very clear transparency and tracking on how funding is used and the impact it is having in the countries in which it is being used.

Caroline Ashley: You asked how best to promote the private sector, and I would probably start first with why. There are very good reasons for a donor organisation to support the private sector, but there are different objectives. Some of them are to do with faster growth and more jobs, and there are lots of types of private sector that you can go for: labour-intensive, investment, SMEs. However, there are also reasons around solutions to poverty, innovation, directly reaching poor people and basic services, what you might call the “better” rather than just the “bigger”. If you want to invest in that kind of private sector, it can be small, it can be start-up, it can be social enterprise, but it can also be multinational. It is more the fact that it is combining commercial return and social return; it is a different type of private sector, and it is not the mainstream. It is really busy, it is vibrant, it is growing, but it is definitely not the mainstream.

Those are the types of private sector that I would want to flag on the radar; it is not the only one, but I think it is incredibly important, with very high additivity and comparative advantage for DFID, because other people are not doing so much of it. In terms of the instruments, they certainly need finance. We work with about 150 businesses across two programmes, and they are all inclusive businesses. They need finance, but finance is definitely not the only instrument they need. There is an awful lot of technical advice needed to get them to the point where they are ready for finance; there is partnership
brokering; there is incubation; there is a raft of things that you need, not just writing cheques.

**Q116 Chair:** I am just wondering whether I can just add another question in before I come to you, Simon Howarth. The impression one gets is that DFID is used to dealing with big organisations and multinationals, and sets thresholds that make it difficult for it to deal with smaller organisations. I suppose the added question is: do you think they could, or should, adjust to be capable of doing that, or does the nature of an organisation like DFID mean that all they can really do is hand it out to intermediates who might do it, whether that is CDC or organisations like yourselves? Even CDC has a very high threshold as well. In other words, is it realistic for an organisation like DFID to reach down to that kind of level?

**Simon Howarth:** On that last point, it is difficult for DFID, because of the limitations on administrative budgets and the number of contracts they can award, or the number of organisations they can work with, but there are ways around that: working with large organisations on partnerships through framework agreements and so on. I think that is possible. On the first question, I come to that from a slightly different perspective, because although I work in the private sector I work mainly on official aid projects, so I am under contract to DFID and other organisations.

**Q117 Chair:** We will have some questions about that later anyway.

**Simon Howarth:** One of the things we try to do through that is provoke the private sector involvement in a lot of activities internationally. In my case, that is mainly to do with private sector management of water resources, particularly for agriculture. There it is not finance that is the critical constraint, but how to do it. It is the technical ideas that are lacking, the institutional framework, regulations and so on. For that, a lot of support is needed to test new ideas and to get that up and running. Finance will become an issue, but at the moment it is not the constraint; it is the ideas that are a problem.

**Q118 Jeremy Lefroy:** I will first just declare my interest that I have known Phil for a very long time and worked with Schluter for 25-plus years. In a recent speech, the DFID Permanent Secretary said that DFID planned to do a lot more in supporting the key role of the private sector in promoting economic development. What I would like to know first is where you see the finance gap for businesses in developing countries. Phil, you have already identified working capital of $10,000 to $50,000 and so on, but is there more to it than that? Open to anybody.

**Caroline Ashley:** Yes. I completely agree about the working capital and the small size. I very much agree with what Chris West said about this enormous playing field to be covered, from the start-up being bankable, being able to get some concessional money on the way to commercial. I think there is one set of business that can generate a return; it will never be a fully market return but it generates such positive public goods and externalities that it needs some kind of impact investment or some blended finance. There is a big need for incubation, start-up, venture capital to get companies on the way.

**Philip Schluter:** There is a lot of expertise that lies both within the private sector itself and within local banks in the developing countries that they are working with. When I look at the commodities sector, the risks are fairly high and there is a quite difficult risk matrix to handle, particularly for an outside consultant coming in. Therefore maybe to be able to provide funds that could give local guarantees to local banks, who could then lend with the knowledge they have of the sector they are working in, would free up some liquidity within-country.

**Q119 Chair:** That is just a good sensible model, isn’t it? As long as there is capacity, what you do is strengthen the banks to do their job. As we know, in this country they have almost failed to do it, and in a lot of developing countries they are dysfunctional. It is strengthening that mechanism.

**Philip Schluter:** Yes. It could be done through the private sector, giving guarantees through the private sector. In terms of whether it is feasible for DFID to do it, I obviously do not know the budget of DFID and how it is divided up in staff time and so on. From where I sit, to allocate more money to staff time, to spend the time to give out smaller amounts of money would give you bigger returns in the end, but also recognise that the recipients have quite a high staff time to track and report the funds they receive. That has quite a high cost for the recipient.

**Q120 Jeremy Lefroy:** If I could just move on, another thing the Permanent Secretary said was that one of the ways in which DFID was encouraging other non-ODA—Overseas Development Assistance—sources of development finance was by sharing risk with private investors to demonstrate that investments can be commercially viable. This seems to me a sensible approach, but is it effective? Can that be done? We are talking here more in terms of not just loans but equity involvement, and the advantage of doing that would be that as well as sharing risks, there would be some kind of reward for the taxpayer as well as the individual business, whereas if you are just making concessional loans, if it does badly the taxpayer loses out, whereas through an equity-based approach the taxpayer would gain some of the upside, which could be reinvested in development.

**Simon Howarth:** That is good in principle. The difficulty comes when you are dealing with meeting basic service needs. If the MDGs are the target and they are what DFID is aiming to meet, then private sector involvement in poverty alleviation is very difficult to achieve.

**Q121 Jeremy Lefroy:** We are talking here more in terms that economic growth is poverty alleviation in itself, and therefore that an increase in private sector activity is a good in that it will generate tax revenues, which will help alleviate poverty. It is not talking necessarily about them being directly involved in the areas like health or education or water.
Simon Howarth: Yes, I agree with that, but it is the question of how you get from the growth to the poverty alleviation that is the tricky bit. That is an area where DFID should be paying attention.

Philip Schluter: I am from a very narrow-sector, so I apologise if my answers are often related to coffee. Within the coffee sector we are an extremely small player, but we have over 600,000 smallholder farmers listed by name, and pretty much every certification scheme we have that requires transparency at a farm level has an aspect of health care and access to education and sanitation as part of the supply chain certification, so you are reaching the Development Goals simply through the private sector having a more transparent supply chain. There are ways to reach millions of, in this case, smallholder producers across Africa and achieve those targets through very small investments in the private sector.

Caroline Ashley: If I can just add, sharing risk with the private sector obviously makes perfect sense, because they perceive risk as high, so it is a sub-optimal investment. The question is how you then allocate the practicality of doing it. It is really difficult to work out where to best put the money, and where it would have happened anyway, and where it should happen. I think it is about having really clear development criteria, and for those I would come back to, “Is it going to translate into poverty reduction?” Because if it is just for investment, there is loads of it out there; how would you ever choose?

Q122 Jeremy Lefroy: Do you have any good examples of where it has worked, and perhaps where it has not?

Caroline Ashley: Yes. We are working with a number of businesses. One is developing a different educational approach for Zambian state and community schools, which is not rote learning but using technology to be more interactive. The entrepreneur has put in a massive investment, but it is really hard going, a very slow slog, so DFID is helping to help it come to fruition, sharing risk. We have some multinational’s investing in LPG stoves for the mass market in Nigeria—again, a massive investment, a much bigger investment from the company than any donor would do, but it is helping to bring down the risk and help the company achieve these years of investment. We have a small Indian company investing in toilets in slums in India, trying to make a private model work. It is very, very difficult, but it is helping to bring down the risk of that. They are all ongoing. I think they are on the way, but I cannot say they have reached it yet.

Q124 Jeremy Lefroy: Those are incredibly helpful examples. Maybe if you could supply us with more information outside, that would help.

Caroline Ashley: Sure.
coordinate it, but very much reporting to DFID on a weekly basis. It is very different from the CDC model. It is run by consultants, in this case it is PricewaterhouseCoopers on the Business Innovation Facility, who are very much used to working with the private sector, so they have certain streamlined processes around due diligence, risk and all that, which I think they are more used to than civil servants. To be honest, over a few years, if you are used to doing these small grants you streamline procedures, and there can be more pressure to do that. I am guilty of designing forms for small businesses and innovative businesses to report to DFID, and I think you have to tailor-make it to some extent and not try to get it off the shelf, so it is useful for the business.

Q128 Chris White: Are you finding this a harder process, or an easy process?
Caroline Ashley: Hard.
Simon Howarth: It needs to be an iterative process, and refined as you progress.

Q129 Chris White: Just a final bit: what do you think donors can do to support SMEs, particularly in the infrastructure sector?
Simon Howarth: I would go back to the technical assistance. With the sort of small companies that I have worked with overseas, it is their technical capacity that is the limiting factor. I do not generally see finance being a constraint, but it is their procedures and their technical capacity that are limiting, and that is where assistance should be given.

Q130 Chair: We have all seen the wonders of Chinese roads in Africa. It is nice to travel on them, but it is a pity that it is not developing the capacity to build roads by Afri cans, and their own contractors and so on. Is there more that organisations like DFID could do, or is that really a matter for the Governments of the countries concerned?
Simon Howarth: I think DFID could do a lot, yes, on building capacity of contractors. It is something they do a certain amount, but I think it is very important, and more could be done, and local consultants as well to design the roads.
Fiona O’Donnell: Can I just apologise? I am going to have to leave after this question, but I may be able to come back. Can I first of all say that absolutely economic growth should be about poverty reduction, but it is not always? Also, poverty reduction should not be the only measure that we need to look at: environment impact, health impact, etc. I think of a project DFID is funding in Malawi for people to become agents for Coca-Cola. That may alleviate the poverty of the agent, but what does it do for access to clean water and to the health in promoting sugary drinks? What I am meant to ask you about is: Philip, you provided some evidence about how concessional funding distorts the market in Africa in coffee. This is to all of you: do you think that DFID should give concessional funding, how can it ensure that it is equitable, and what could they do better to ensure that these distortions do not happen?

Philip Schluter: I would say it will always be messy, unfortunately. If you fund one project you will probably always find another project that wished it was funded, I confess I have spent a couple of hours looking at the DFID website on the way down, and seeing quite a few projects and funds available that I did not know existed. I think that is part of it: making more widely publicised what funds are available, so that more people within a sector can have access to them. Maybe going through trade associations, which are related to the sector that the funds are targeted at, would mean there is a fairly wide availability of those funds. Then you can probably get them spread more widely over the recipient community.
There will always be a danger that a funded project is competing with a non-funded one, perfectly viable before the funded project came and competed with it. Looking at the coffee in East Africa, there are huge areas that are completely uncovered and untapped, and could do with assistance. It is about making sure that when target funding goes in it does not just set up in an area where there is already a lot of work going on, but targets areas that are not receiving any.
Caroline Ashley: There are definitely times when grant allocations from Governments or donors cause problems for private sector provision. Sometimes that is a good thing, because, hey, somebody may get a free education; that is not a problem. Sometimes it is a bad thing, because people are not being given vouchers to buy something; they are being given the wrong thing, where a market system might work better. You have to take that case by case. Leaving that aside, there are three times when concessional finance can be useful.
One is when the private sector venture can generate a commercial return, though below a market one, but generates real public good. There it will in the long-term need concessional finance, but it will be totally sustainable if it has it: impact investment, eat your heart out.
The second one is on the way to market commercial finance, but it needs this venture philanthropy, this concessional finance in that journey for a few years. The case for that is clear, and it is making sure that when you need concessional finance. The problem is identifying what the trajectory of this business is: is it that business that will get there if I provide this?
The third one, slightly similar, is when other commercial finance will come in, but because it is an unstable country, because political risk is deemed as high, they need someone to take a lead and to take a risk. Maybe the slightly concessional finance is willing to bear a bit more of a risk, but the rest of the investors will then come in on a commercial basis, and I think all three of those can have high development impact, if used correctly.
Simon Howarth: I don’t think I have anything to add to that. I agree with that absolutely.

Q131 Mr McCann: This Committee has expressed concern in the past about DFID’s ability to bulk up their work in private sector investment areas. The one that springs to mind would be our concerns about the
India programme and their re-focus on the private sector. Do you think that DFID has the right skills and staff to work effectively with the private sector?

**Caroline Ashley:** I have a lot of admiration for the way DFID has innovated in this space, and I do think it is ahead of other donors. In terms of leadership, thinking, creativity, DFID has certainly had a very good approach. The day-to-day engagement with the private sector takes a set of skills, or a blend of skills, working on development with clear development objectives and working with the private sector on due diligence, risk, contracting and everything. Whichever way you do it, you will need that blend, whether you put development people into a PwC or a CDC or whatever, or you put people with private expertise into a Civil Service Department; it does not matter. You will need that contrary mix of skills, and that is where the best productivity comes, but it is crafting the best way to do it.

DFID has obviously increased private sector expertise, but I still think if DFID wanted to bring everything in-house and not do it through contractors, it would obviously need to bring in more, because at the minute a lot of it is controlled by DFID, but done through contractors.

**Simon Howarth:** DFID has taken quite a lot of new staff on in this area, including secondees from the private sector, to strengthen its capacity.

**Q132 Mr. McCann:** You have touched upon it already: is there any way they can improve that interaction with the private sector, or would it be the normal, traditional routes, which would be secondments in and out of DFID to the private sector? Is there anything else you can think of that would be helpful?

**Simon Howarth:** I think there probably is scope for much closer interaction. It is probably quite difficult for a private company to interact on a daily basis with DFID. If there was a more free exchange of ideas, that would probably help.

**Caroline Ashley:** I am a development person working with people with private sector expertise, and the people I am working with, I do not see them being mainstream DFID civil servants. They could go and do this private sector work in DFID, but you could not then move them on to running education departments in Uganda, or whatever. Because I would not see them as generic civil servants, some kind of secondment system seems to be the way if you are looking to bring it in-house, rather than contracted out.

**Q133 Chair:** That just raises a fundamental question: is this an area where an organisation like DFID can effectively expand without causing all the problems the questions are addressing? Is it inherently in the DNA, or can it be built into the DNA of an organisation like DFID that is comfortable in those interactions?

**Caroline Ashley:** Yes.

**Q134 Chair:** You think it is. That is a fundamental question; I am glad to hear it. So we are not completely wasting our time.

**Caroline Ashley:** It is about partnership, and I think DFID is up for that.

**Q135 Pauline Latham:** This is particularly a question to Caroline Ashley. How should DFID measure and assess the impact of its private sector investment? You have cautioned against an excessive focus on jobs in impact monitoring, arguing instead for a less tangible measure that recognised enhanced livelihoods. But isn’t employment a proven way to empower people to pull themselves out of poverty?

**Caroline Ashley:** Employment is great and it is one very good measure. If you are investing in the private sector to generate growth and jobs, then that is great. But if you only use jobs as your measure, you will then exclude a lot of partnership with the private sector that is very innovative and very important for a lot of poor people, but is not directly employing them. There is a lot of innovation going into working with farmers down the supply chain, where they get better access to finance, to seeds and to markets. They increase their productivity, they increase their security, they increase their investment. It is not really measurable in jobs; certainly the company doing the innovation is not employing them. That is really important and certainly fits with the coffee chain examples.

Then there is a host of others doing some of the things I talked about before: mobile apps for farmers, improved stoves, education, health, sanitation, toilets. They employ maybe 13 people, maybe 300 people, but they do not increase the jobs very much. However, they might reach half a million people, and for those half a million who get access to something that we take for granted and they cannot, it is really important. That is why I would argue against just having jobs.

**Q136 Pauline Latham:** So it is not that you are against jobs as one of the criteria, but you are looking at other things as well.

**Caroline Ashley:** Yes.

**Q137 Pauline Latham:** Where would microfinance sit with that? If you are looking at letting women, say, have access to microfinance and therefore buying, I don't know, some goats or a cow, would you count that as a job, or would you count that as, “it is just helping the whole family”?

**Caroline Ashley:** Different programmes and different evaluators have different ways of defining a job and whether it is a full-time equivalent, and whether it is direct or indirect. The easiest thing to count is the number of people at the base of the pyramid, the low-income people reached. That is the easy one that hopefully all of us can do. Then I would qualify it on how they benefit, and in that case it is how many are making some productive investment for their livelihood. You can call that a job if you want to, but I am really interested in how many women get a productive investment out of it that helps them.

**Q138 Pauline Latham:** Does anybody else have a comment on that?
Simon Howarth: One thing I would be cautious about is, if you are dealing with a situation of smallholder farmers, you might find a small company coming in, renting land, growing commercial crops on that land and employing some of the farmers, but actually some of the others are dispossessed as a result of it. So, from an employment point of view, it might look good, but from a poverty point of view, it might not be so positive.

Q139 Pauline Latham: Obviously, Phil, you have experience from the coffee sector.

Philip Schluter: Most of our supply chains are subsistence farmers who are not employed at all, but you can monitor their increased revenue through the certification schemes and the agronomy that is done with them. That also is difficult to track. Commodity prices are highly volatile. Ours has just dropped to 40% of where it was 18 months ago. There is some very good work going on with smallholder farmers that will give them maybe 30% higher income than they would otherwise have had in the same market, but their actual incomes have dropped by 50% due to the world market in the last 18 months. Again, we need some knowledge of how to measure that impact, but you can increase revenues for smallholder farmers by 30% with very little investment.

Q140 Pauline Latham: Do you think DFID gets that?

Philip Schluter: I have to say, I have had very little interaction with DFID as a whole. I understand they do do some work. We are working with similar organisations in other European countries, some of which do get it and some of which are learning very fast—as I understand DFID is—that it is not so difficult to do once you start doing some projects and see the impact, but you do need a great deal of flexibility in how you do your monitoring and how you assess the impact you have had. I see DFID has a desire to work in unstable and conflict zones. We are working in Goma in DR Congo with smallholder farmers there on a project where we have only managed to achieve half our targets over the last two years. But, in the circumstances we have been working on, that has not been bad.

Pauline Latham: Pretty good, yes.

Philip Schluter: It is having flexibility to recognise those sorts of things.

Q141 Pauline Latham: Did you want to comment on that?

Caroline Ashley: Different staff at programme level get it, but you need flexible, project-specific indicators. Of course, DFID also needs a few simple indicators to agree with Treasury and to report to people like you. It is the old tension between the specific and the universal. That is where the tension is.

Q142 Hugh Bayley: Is it not important to remember that the use of British aid in private sector projects has, at the very least, a chequered history? I remember when John Major was Prime Minister, there was the scandal of the Pergau Dam, where £850 million of British aid—British taxpayers’ money—was used to fund a hydroelectric scheme, which the then Permanent Secretary of ODA, Sir Tim Lankester, called “a very bad buy” in development terms. Later, it was found that actually the money was a bribe to the Malaysian Government to buy British aerospace jets. I was introducing a private Members’ Bill at the time to require British aid to be used for poverty alleviation, which was met with howls of derision on the Government side. “How on earth will we support British business if you limit aid to poor people? They won’t buy Land Rovers,” they said. So how can DFID, if it goes down this road—which it says it will; which it is—ensure that private sector support remains compatible with its primary objective of relieving poverty in poor countries?

Simon Howarth: The Pergau Dam was a case of very badly appraised budget and I do not think that that sort of project would be approved under—

Chair: To be fair, Hugh, your Government introduced the International Development Act to change the basis.

Simon Howarth: The private sector has environmental principles now that would have ensured that the Pergau Dam was not implemented or was implemented in a much better way than it was at that time.

Q143 Hugh Bayley: But the fact remains that the Pergau Dam was not a way of relieving poverty in a middle income country: Malaysia. It was a way of driving poor people off the land and allowing big farmers to make money.

Simon Howarth: Yes, but you have to have environmental and social safeguards in any project like that. Since that time, there has been the World Commission on Dams, which has recommended wholesale changes in the way that such large water infrastructure is implemented. That has been taken on board by the World Bank and all the major donors, and also by private sector investors, so the Equator Principles apply.

Caroline Ashley: I remember Pergau well; I worked here at the time. I think you are right: there are safeguards now, but it is also a cultural thing about how aid is managed and how we hype it. I have three suggestions. One is to avoid hype about aid and the private sector. I do feel there is too much hype at the minute and, to be honest, that leaves it very open to critics, but it also means that people get a bit carried away with it. Secondly, related to that, it is still important for development people to be very honest about the negative impacts of the private sector, and not just welcome the areas for collaboration, but be really clear where it is bad for development. They need to ensure that aid money is also spent on minimising negatives and dealing with transparency and sustainability initiatives—all the things that are ironing out some of the problematic elements of private sector engagement in developing countries. That is still needed.

The third, which I think is really what you were implying in your question, is being very, very clear on the objectives of private sector engagement, and seeing the private sector as a means to something,
whether it is jobs or whether it is reduced indoor air pollution or whatever. I have been horrified in my work at how, in our team, we really thought we knew exactly what we were doing and why we were doing it and everyone got it, and two and a half years into our programme, we started getting questions that suggested people just did not get why we were working with the kind of companies we were working with. We went back to the drawing board and started trying to explain to people more simply the logic of what we were doing. We have been guilty of not explaining the logic well enough, but I think every DFID engagement, every donor engagement with the private sector, has to be very clear on its logic chain and explain that much more than in other sectors.

Philip Schluter: I would say you have that tension in every well-meaning organisation that is looking to improve lives and develop things. You need to be very clear on the objectives, be they social, environmental, economic; they are the three pillars we see in every single certification scheme we work with, although they may vary slightly on how they measure them. You need to make sure that you have very clear objectives that are measurable built into any project that you want to do with the private sector. If you look at Fairtrade, they have just split between the US, who think they should support anyone who will meet the criteria that they have laid out, and the Europeans, who believe they will only work with the poorest of the poor, who they consider to be smallholder coffee farmers. Within an organisation like that, which is extremely ethical and clear, there is still a tension between whom they are willing to work with. But if you have very clear goals and targets—and your private sector need to lay out before you, before they get any funding, how they are going to help that process constructively. The other issue is still a tension between whom they are willing to work with. But if you have very clear goals and targets—and your private sector need to lay out before you, before they get any funding, how they are going to help that process constructively. The other issue is still a tension between whom they are willing to work with. But if you have very clear goals and targets—and your private sector need to lay out before you, before they get any funding, how they are going to help that process constructively. The other issue is still a tension between whom they are willing to work with. But if you have very clear goals and targets—and your private sector need to lay out before you, before they get any funding, how they are going to help that process constructively. The other issue is still a tension between whom they are willing to work with. But if you have very clear goals and targets—and your private sector need to lay out before you, before they get any funding, how they are going to help that process constructively. The other issue is still a tension between whom they are willing to work with. But if you have very clear goals and targets—and your private sector need to lay out before you, before they get any funding, how they are going to help that process constructively. The other issue is still a tension between whom they are willing to work with. But if you have very clear goals and targets—and your private sector need to lay out before you, before they get any funding, how they are going to help that process constructively.

Q144 Hugh Bayley: Is it not important to go further than that and say that goals and targets have to be about poverty alleviation? If it is a target about job creation or about growth, you can provide huge benefits for a middle-income stratum without helping the poorest people, who surely should be the focus of our aid. How do you differentiate between what we support? How, in our team, we really thought we knew, export credits or something like that, because it is good mutually for growth in the UK, and growth in India, shall we say, and what you support through DFID to alleviate rural poverty in India?

Philip Schluter: I would say there is a big danger there. We need a growing middle class in the countries I work with in East Africa because, without one, all the value added is added by international companies who come in and have that ability and infrastructure to fill that gap, provide the finance, buy the coffee from smallholder farmers, process, add the value and take the value outside the country. Unless you can build up a middle class with the finance and ability to do that within the country, your actual economic growth within the country is completely stunted, because it all goes outside. Now, they need to prove that they are working with the poorest and alleviating poverty, but to leave them out of your equation of whom you are willing to work with is an error. It is not difficult to define criteria for poverty alleviation that are easily reportable.

Caroline Ashley: You might have touched upon on the most challenging aspects of future development, particularly of engagement with the private sector, which is defining who is poor. Your 600,000 smallholders quite possibly fall below one of the international poverty lines—1.25 or 2.5—but a lot of private sector engagement will engage with people who are above that poverty line but still below middle class. It is a big strategic decision. Are they people that taxpayer money should be spent on helping? They really do lack necessities. Those international poverty lines are so low. I think it is worth some aid reaching them, but they might not fall below that 2.5 or 1.25. It is a really unanswerable issue.

Simon Howarth: I think there needs to be a really well-defined theory of change, so that you understand how you are going to get to these very poor people, however they are defined. We have to decide who you are targeting, but you have to make sure, whatever you do, if it is aimed at a higher level, that it will feed down to poverty alleviation at the bottom.

Q145 Chair: The point we are exploring is, first of all, those countries that have succeeded in lifting most of their people out of poverty have done so by expanding their private sector. Now, the point is it may or may not be because of aid engagement. What we are looking at is whether or not aid engagement can help that process constructively. The other issue is we are looking at is the fact that there are a lot of poor people in middle-income countries—and it may be the point you are making—and to what extent we can engage with them and help those countries, if they cannot help themselves, lift those people out of poverty. I think Hugh Bayley's point is the centre of gravity of the Committee: it is also the legal basis on which we are operating. The fundamental focus of UK aid and development is to lift people out of poverty. It is pro-poor, but it is becoming more complicated, and I think that is really what we are trying to tease out.

Q146 Jeremy Lefroy: Just going back to this question of jobs, I understand what Caroline was saying about the need to be cautious of an excessive focus on jobs, but the fact remains that, as one of my colleagues has said, jobs or having work—let's not confine it to formal sector jobs—is probably the single best way of enabling someone to get out of poverty. We are seeing increasing rates of workless people around the world, including in the developed world and particularly among young people. I just wondered how you felt that the British development programme, in its target of tackling global poverty, can be more focused on the creation of effectively remunerated work, because that seems to me probably the single greatest challenge that we face.

Caroline Ashley: I agree with your problem statement. Our Nigeria country manager is adamant that 16 to 30-year-olds are completely excluded, and it is the biggest problem that Nigeria faces. They do not want to necessarily stay in agriculture. I am sure many of your coffee farmers are trying to invest in
education so their kids do not coffee farm, which is a problem for coffee farmers, but not necessarily for them. It does bring you back to small and medium enterprise and getting the financial system and markets working for those young people, many of whom have some education, to try to get access to credit and access to something in the local economy. It is not easily solved. It is not my area of expertise, but it definitely does not just rest on agriculture.

Q147 Jeremy Lefroy: This is bringing us back to access to finance and access to credit.

Simon Howarth: I still think that subsistence agriculture will remain essential for a lot of people. I am working in Western China at the moment, which is not a country that DFID is interested in at the moment, but there are a huge number of very poor people there, and it is very difficult to reach them. A lot of them are able to move out of poverty by migrating, and then the local economy relies on remittances, but this does leave some people very disadvantaged still. It is still a major challenge for the Chinese Government, with all its resources, to alleviate poverty in the remotest parts of the country.

Q148 Chair: You all seem to be saying that you think there is scope for an organisation like DFID to do more to help this pro-poor private sector development and you think DFID is capable of doing it. Do you have any view as to whether that is best done through the currently existing structure—private sector partners—and then through intermediaries, whether it is yourselves or other agencies? Or is it the case that DFID should actually move into the business of providing finance, if that is what it is, in the form of, say, a development bank? Do you have any views as to whether either of those options are or are not a good idea?

Simon Howarth: It is rather outside my area of expertise, but I would have thought DFID should remain one step removed from it. I think it would be slightly uncomfortable moving in that direction.

Caroline Ashley: I think DFID should try to do what other donors do not do: have greater additionality. I think other donors do development banks.

Chair: They do.

Caroline Ashley: DFID has got CDC. Obviously, CDC could move into other spaces, but the effort of setting up a whole new development bank that is somehow different from CDC seems an enormous investment, so I imagine you would need to be really convinced that there was a space for it and it was worth it.

Philip Schluter: I think there are a growing number of people who are filling that gap and doing it quite effectively with good expertise in the market, who could do with more concessionary finance that they can then pass on. It is just a matter of setting up a good reporting mechanism whereby they can report back to DFID, but I would think that understanding that sector and spending some staff time doing that will pay greater dividends than trying to do it yourselves. But I am, again, not a great expert on it.

Q149 Chair: Is there anything else you want to share with us? I can say, obviously, after this session, if you reflect on the exchanges and you have any additional thoughts, please feel free to communicate them to us. You are not required to, but I don’t want you to leave thinking, “Oh, I should have told the Committee.” If not, can I thank all three of you for the different perspective you have brought to us? I hope you can see from the exchanges what we are trying to tease through in terms of how things would change.

I don’t think it is out of order, but we had an interesting session with the President of the World Bank and did ask him what he thought about DFID moving into having a development bank. I expected him to say, “I think the world’s got plenty of development banks. It doesn’t need another one and we’re quite a good one in the World Bank.” But he said quite the opposite. He actually said, “I can’t think of any organisation better equipped to do that, and we’re going to need all the support we can get.” So, to my surprise, he was quite positive about it. But you have also hit on the fact that it is not something you can do overnight and, in any case, you probably need a mix of instruments. It is not as if providing loans in-house and developing a development bank are mutually exclusive. You can do one without the other, or you could do them in tandem, I suppose. That is really what we are trying to explore. If you have any further thoughts on reflection, we would obviously be very happy to hear them.

Caroline Ashley: In response to that, I would say the key thing is not just to think about finance. Finance is needed, loans are needed, but there is so much else that particularly DFID can do, because it understands the issues: brokering, innovation, partnership, technical support.

Chair: Well, obviously you put some of that in writing. If you have any further thoughts, please feel free to communicate.

Q150 Jeremy Lefroy: There was just one thing I wanted to mention that came out of DFID’s response to our report on global food security, in which I thought DFID did not get it because one of their answers was that they did not believe that agricultural extension, for instance, was of any great importance. Given the history of this—and I understand it is a very chequered history—I thought that was a pretty sweeping statement, so I was rather concerned to hear DFID say something like that.

I wondered if, perhaps, any of you could comment on that, given that the biggest area of creation of improvement, of maintenance of employment and jobs around the world is in agriculture, particularly small-scale agriculture. Would not agricultural extension be something that was fairly logical in terms of training? You just talked about that and now DFID seem to be saying, “Actually, we don’t think that’s particularly important, certainly not as provided by Government—maybe the private sector, but not as provided by Government”, which was contrary to our views as the Committee.

Philip Schluter: I would guess there is a fairly large correlation between countries that have managed to bring the bulk of their population out of poverty and
I am Diana Noble. I am the Chief Executive Officer of the Infrastructure Development Group.

Edward Farquharson: I am Edward Farquharson and I am the Executive Director of the Programme Management Unit of the PIDG—the Private Infrastructure Development Group.

Diana Noble: I am Diana Noble. I am the CEO of CDC and have been since November 2011.

Holger Rothenbusch: I am Holger Rothenbusch. I am Managing Director at CDC, responsible for debt and structured finance.

Q152 Chair: Good morning. Thank you very much for coming in to see us. In the case of CDC, thank you for coming in again. I think you were all sitting in on the previous evidence session, so you will have some idea of the context. A gain, just for the record, I wondered if you could formally introduce yourselves.

Edward Farquharson: I am Edward Farquharson and I am the Executive Director of the Programme Management Unit of the PIDG—the Private Infrastructure Development Group.

Diana Noble: I am Diana Noble. I am the CEO of CDC and have been since November 2011.

Holger Rothenbusch: I am Holger Rothenbusch. I am Managing Director at CDC, responsible for debt and structured finance.

Q153 Chair: Thank you very much. In the context of the inquiry we are doing—the future of UK development co-operation, the role of loans and finance in particular and the engagement with the private sector—you would absolutely expect us to want to talk to CDC about your role, and indeed PIDG, which has developed a remarkable track record and is the core area of our work. But it is a question we treat very carefully, because one of the reasons why PIDG works quite well is that the Committee will have a strong alignment of purpose and approach amongst our members, so we would not just go out and try to get any member.

Q154 Chair: Are you continuing to attract new donors as contributors?

Edward Farquharson: Interesting you should ask that, because we are in discussion with one at the moment. But it is a question we treat very carefully, because one of the reasons why PIDG works quite well is that there is a strong alignment of purpose and approach amongst our members, so we would not just go out and try to get any member.

Q155 Chair: CDC? Diana Noble: CDC’s goal is to reduce poverty across all of Africa and South Asia, and we are one of the tools that DFID uses to achieve this. More specifically, our mission is to support the building of businesses to create jobs and make a lasting difference to people’s lives in some of the world’s poorest places. We have made big changes since I joined, and if the Chairman feels there is time later, I would be happy to update the Committee more fully because it is now 15 months since I was last in front of you, and there has been much progress. So I will limit my comments to three points. Firstly, we have refocused ourselves on development impact and our targets and compensation are all aligned around those. I can talk much more about it, but, in essence, we want to be a DFI with a capital “D”.

We have also moved away from a narrow provision of capital to private equity funds, and we now provide all forms of capital directly and indirectly. The most successful investment that we can attract with the public money that we use to put into those projects. To date, that is about $28 billion. So, for the $1.5 billion that goes into the projects that PIDG facilities supply, there is $28 billion of co-financing that it has attracted with it into getting those projects going. But it is not just private finance that we measure. We also measure jobs. We also measure the fiscal impact for Governments and, finally, we also measure the number of people who actually benefit from new or improved infrastructure. I am happy to go into the statistics on that.

Q156 Chair: Can you tell us more about your performance?

Edward Farquharson: The PIDG has developed a remarkable track record. We focus obviously on infrastructure—that is our core area—and we do that by providing long-term finance to projects that have what we call reached financial close; in other words, they now need the money to build the infrastructure. But we also provide finance and support at the very early stages of project development. In a sense, we were designed to try and support those blockages that are stopping infrastructure projects going forward with private sector investment throughout what we call the project development cycle.

We measure the impact of what we do quite closely. One of our key metrics is the amount of private sector investment that we can attract with the public money that we use to put into those projects. To date, that is about $28 billion. So, for the $1.5 billion that goes into the projects that PIDG facilities supply, there is $28 billion of co-financing that it has attracted with it into getting those projects going. But it is not just private finance that we measure. We also measure jobs. We also measure the fiscal impact for Governments and, finally, we also measure the number of people who actually benefit from new or improved infrastructure. I am happy to go into the statistics on that.

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Q161 Chair: That is something the Committee will continue to take an interest in, and if we did not, Mr Lefroy would make sure that we did. You made a very important point that raising agricultural productivity is a key way of getting people out of poverty. Thank you very much indeed; it is much appreciated. It has been a very useful session.

E xamination of Witnesses

Witnesses: Diana Noble, Chief Executive Officer, CDC, Holger Rothenbusch, Managing Director, CDC, and Edward Farquharson, Executive Director, PIDG Programme Management Unit, gave evidence.
brought with me today Holger Rothenbusch, who heads the new debt and structured finance team at CDC. His experience is particularly relevant to today’s discussion because he joined us from DEG, and so can talk with experience about the German model of running a DFI, which is DEG, alongside a development bank.

Chair: We have already taken evidence from them as well.

Diana Noble: The third point I want to make is: one of the most exciting things about our new strategy is the ability it gives us to work more closely with DFID. Of course, DFID themselves are assessing their strategy for the private sector and we have to wait for this to conclude, but we are already exploring opportunities to collaborate on the benefit of those living in poverty across Africa and South Asia. Having said all of this, CDC of course is not designed to solve all development challenges; we are just one important part of DFID’s strategy to harness the power of the private sector to alleviate poverty.

Chair: We would like to hear more about the changes, but that is precisely the question I am going to ask Pauline Latham to come in on.

Q156 Pauline Latham: You touched on the fact that you have changed since our report in 2011. Can you tell us exactly how you have changed, and how your operating model has changed? Obviously, we said that CDC should do more to reduce poverty, especially in those world’s poorest countries. Can you explain how you have adapted to that challenge?

Diana Noble: Yes, of course. Let me start with activity levels since last year. Activity levels are running at a very encouraging level. We have been extremely busy this year, and we are actually ahead of where we expected to be. During 2012, we made nine new commitments, or investments, for $232 million and this year we are expected to be over 30 for over $1.1 billion. Clearly, we are not at the end of the year yet, but that is where we are expected to be. This growth is driven by the two teams we started from scratch last year: one to invest equity directly in businesses, and the other to provide debt and structured finance. Of course, just making investments does not fully realise our mission. We have to make the right investments, and those that maximise the prospect of achieving development impact while making a reasonable return. Then, over time, we need to achieve that impact, measure it, show it and get our money back for the return.

The last two, obviously, will take years to achieve, but what we can do is demonstrate that the investments we are making are well matched to our mission, which is to create jobs especially in the hardest places. With the help of Stefan Dercon—DFID’s Chief Economist—and some other economists and academics, we have created an ex-ante tool that helps direct our capital to those opportunities that have the greatest chance of creating jobs and also incentivises us to invest in the harder places rather than the easier places.

That means we actually now turn down lots of opportunities that we see to invest where we do not believe that the impact will be sufficiently high. This tool is also linked to our long-term compensation, so we are all aligned with genuinely achieving impact with our capital. A third, this increased activity, focused on Africa and South Asia and away from the rest of the world, is shifting our portfolio. At the beginning of last year, 46% of our portfolio was outside of our new focus geography, and only 36% was held in Africa. By March of this year, Africa had gone to 48% and historic geographies had shrunk to 29%. We expect that trend to continue in future. I will just give a couple of examples of things we are doing. We have invested $32 million in Indorama, which is a Nigerian fertiliser production facility that turns flared gas into fertiliser in the Niger Delta. That will bring, we hope, in time, improved agriculture yields in Nigeria and self-sufficiency in fertiliser production in a country that currently imports 95% of its needs.

We have invested $17.5 million in Rainbow, a children’s health care chain in South India. It is a centre for excellence in paediatric training and development and we expect it to create as many as 3,000 jobs and raise standards nationwide. We also invested last year $32 million in EFG, an African agribusiness company with operations all across the continent. It connects hundreds of thousands of smallholder farmers to the international market through its network of distribution and processing centres.

We have got a number of other direct investments in the pipeline including a green energy infrastructure business in India, a power generation and distribution company in West Africa and a farming operation in DR Congo. All these deals are just examples of the type of challenging, commercially sound but job-creating opportunities that we want to be known for under our new strategy.

Q157 Pauline Latham: That is very encouraging. You said that you are often invited to invest in areas that you do not feel will have a big enough impact. Is somebody filling that gap; is there an organisation taking on those less risk-averse opportunities?

Diana Noble: Yes. In some cases we say no, because we actually think that the private sector is perfectly capable of funding something. We sit around the table with every single investment and say, “Is this developmental enough? Is this something that someone else’s capital could do better than us? Is it something that we are genuinely bringing value to? And, of course, ultimately, is it going to be commercially sound so we protect our balance sheet?” We ask ourselves those hard questions on every single investment.

Q158 Chair: In our report on the organisation, which I think has led to some of these changes, there are a couple of things we ask for. One is more direct investment of a smaller scale. I wondered if you could give us an indication of how far down your direct investments are. The other thing we suggested was splitting the organisation, as you will recall, which I think the Government did not do, because we also thought you should take more risk. The counter-argument was, “Well, of course, if you were taking
too much risk, you wouldn’t attract other investors.” You have given us a very impressive list but, given that you are going towards difficult areas and presumably taking more risks, what impact does that have?

Diana Noble: Of course. Let me answer the first question on small finance. Our strategy is designed to get appropriately priced capital to all levels of African and South Asian countries, or economies, to small—to micro, actually—medium and large enterprises. SMEs are incredibly important in our strategy. We know it is one of the areas that we can be most additional, and 460 of the 1,250 companies we support today are SMEs, which is quite a big proportion. But we also do not think they are the only way to create employment or balanced economies. We support micro-enterprises through our microfinance strategy. We support financial institutions, because local banks are very well placed to assess and lend to their networks of small businesses. We support medium and large businesses and we finance the construction of essential infrastructure. All these things are badly needed in the regions.

That is the reason they see. On taking more risk, I believe that, with the changes, we have taken on board the need to take more risk across all our strategies, but we have also started a new approach to think about getting capital into the really very hard places. So we have a frontier strategy and we have hired a very small team to start looking at some of the very hardest countries. They are starting with North Nigeria, South Sudan, Myanmar, and Nepal, and they have taken a look at what approaches have and have not worked before in very hard places. We expect, over time, to increase the amount of capital that goes to these places because of a proactive strategy, although, of course, this will take time.

Q159 Hugh Bayley: You talk about doing partnerships with local banks in Africa. Certainly, generally speaking, I got the impression that local banks are not good partners for small and medium-sized enterprises. They are very reluctant to lend. If they do lend, they are very inflexible in terms of terms and conditions and the interest rates they charge are extremely high. Can you give us a couple of examples of where you have made a partnership, and what difference your partnership has made to the availability or attractiveness of finance to small businesses?

Diana Noble: Of course. I might pass this question to Holger because this is his area.

Holger Rothenbusch: One of the examples, which happens to be one of the oldest investments of CDC in a different guise, is a company called DFCU Bank in Uganda. It was co-owned by CDC in 1964, together with the Ugandan Government, so it has gone through different incarnations. During the last years, it was very much operating as a commercial bank. Over the last 10 years, CDC owned 60% of the bank and we, earlier this year, sold 45% of that 60% stake, partly to Norfund, our partners from Norway, and partly to Rabobank.

Through doing that, we have achieved several things: we have introduced a technical partner with Rabobank of the Netherlands, which is one of the biggest banks, among others, and is very strongly focused on agri-business, which in particular in East Africa and Uganda is a very important sector. Rabobank is going to support the bank in terms of designing products that are designed to enter into the rural areas to provide agri loans to local farmers more appropriately than could have been done so far.

We are also in conversations with the bank at this point in time to provide debt funding to the bank, in order to be able to continue serving their main customer segment, which is SMEs. If you look at most African banking sectors, it is such that you have state-owned banks that are very much financing state-owned business and are largely subscribing to T-Bills and such things, so they are not very effective in lending locally. If you have the international banks, most of which are indeed focused on either international corporates or local blue chips or, then again, invest in T-Bills. They do treasury; they do cash management services; they do not take risk.

Then you have the mid-sized, local, private banks. That is where lending really takes place because the other segments have pretty much done their bit in other segments, so they really have to go to these markets. DFCU is a very good case in point. DFU is the biggest provider of SME finance in Uganda and, through the continued support by people like CDC with the new lines of credit that we now make available, it will continue to be in a position to do so.

Q160 Jeremy Lefroy: Could I just have one follow-up on CDC? One of the other things we mentioned in our report was recruitment and remuneration of CDC. We said that we did not think it was necessary to pay extremely large salaries to attract the best people. We thought that the work CDC was doing was sufficient to do that. I wondered if you had made any progress on that?

Diana Noble: Yes. One of the first things I did when I arrived was to completely overhaul the remuneration framework. We make it very explicit: if you are the kind of person for whom personal financial gain is your prime motivation, CDC is not a great place for you. That is not a value statement; people have to earn money at different times of their lives. But if what you are really interested in is using your skills and your investment skills to achieve impact in the countries where we work, we are a great place.

Obviously, it has taken a lot of effort to shift it from where it was to where it is now, and we did not keep all the people that I inherited, but we have made great steps in rebuilding the team around the new remuneration framework. I inherited 45 people at the end of 2011; 30 of those are still with us. We recruited 30 new people last year and expect to recruit a further 45 people this year. These are the people who are responsible for the increases in our activity levels that I was talking about. We expect to continue to grow next year, probably a bit more slowly. Even at these numbers, CDC is the most effective of the large European DFIs. Proparco, for example, has the same size balance sheet and has nearly 200 people. We are still working at a level well under that. We should be at 100 by the end of the year.
Q161 Jeremy Lefroy: Thank you. If I can just move on to PIDG, when we spoke during our infrastructure inquiry, we recommended that DFID should increase its funding to the PIDG. We saw it as an effective tool, and particularly thought that it should be extended to the agricultural sector, where infrastructure need is particularly acute. Could you perhaps update us on that?

Edward Farquharson: Yes. In agriculture, it is a small part of our portfolio; it represents about 2.5% of our total investments to date. What we have done following the strategic review that we conducted with our members last year is to decide that agriculture is a frontier sector that we do need to concentrate on. What we have just completed in the last month is an extensive scoping review to see how we should engage with or do more in the agricultural sector. That is not to say that we are not already doing stuff there, but we are looking at how we can do a lot more. That is actually being debated amongst the donors as we speak.

The interesting findings from that report were that, when we look at Asia and Africa, there are very different approaches that need to be taken. For example, we have discovered that the need in Asia is very much around value chain investment. It is not at the primary agricultural level; it is at investing in things like logistics, markets, storage. That is a strategy of our InfraCo Asia facility, so they are going to continue doing that, and they are already looking at a number of projects in that sector.

With Africa, the situation is a bit different and a bit more complicated because the primary need for infrastructure is really at the farm level. What that means is that one has to assess not just infrastructure risks but actually farming risks. That brings with it a load of questions about being very close to understanding what those risks are. The other issue that has come out from that, interestingly, is that the type of input—the type of finance—needed in that sector in Africa is really incremental equity or patient equity finance, which is a rather different product from, say, the project financing that we use for say larger-scale power projects in many parts of PIDG.

We are now debating with ourselves what is the best way to take this forward; how can we make sure that the boards are equipped with the right sort of skills? At the same time, we have taken on board AgDevCo, which is a specialist provider of finance to smaller agricultural businesses in Africa. That is now what we call an affiliate of PIDG and, through the PIDG Trust, DFID have put some additional finance into AgDevCo. So it is a work in progress; there is more to be done.

Q162 Jeremy Lefroy: Just to answer the question about DFID increasing its funding of PIDG, have they done that?

Edward Farquharson: Yes, they have very much so. They approved a business case for a multi-year core funding programme of £477 million for PIDG.

Q163 Jeremy Lefroy: How many years is that?

Edward Farquharson: That goes through to 2014–2015—or 2011/12 through to 2014–15—and they have so far disbursed to PIDG about £230 million of that £477 million. It is obviously programmed to come in over a number of years. They have also built into that a contestability mechanism that means that, if you do not perform as a facility, you get a reduction in the amount of funding they are anticipating providing the facility.

Q164 Jeremy Lefroy: As I understand it, PIDG has a revolving finance element, in that PIDG is there to, if you like, sell the ideas—the project—on for a fee, which it can then reinvest. There must come a time therefore, when PIDG has sufficient money from DFID in it, because it has been getting money back from the projects that it has been working on, that it does not need further DFID funding, provided it is at the kind of expanded level we had envisaged. When do you think that will happen?

Edward Farquharson: One has to disaggregate PIDG into its different facilities. You are quite right that two of the facilities are exactly doing that: they are taking early stage risk, developing projects and then seeking to sell them on. But it is not the only activity that we are involved in. I would say that, in terms of that particular activity, we are still quite a long way from that becoming a self-financing, sustainable model given the early stage risks that are involved in developing up projects. We are just getting to the stage now where we are beginning to sell some of those projects and get an idea about how much money we are getting back from the money that has been invested.

But your point is very well made because, in the other facilities, particularly the financing facilities that are lending senior debt to projects, those projects have been around for some time. So EAF, our first financing facility that began in 2002, is seeing repayments from its loans and it is recycling those in to new loans to new projects. But given the scale of the problem—we estimate there is probably about $13 billion per annum of private sector remunerable funding requirements, so to speak, in our markets—there is a lot more that can be done using the PIDG model to address that.

Q165 Jeremy Lefroy: Finally, does PIDG—or through its affiliates—ever take equity stakes rather than just make loans, so that if the project happens to be very successful in the long term, it can actually make a lot of money back? Also, supplementary to that, is PIDG working with CDC, because obviously there are certain investments, particularly if you go more into agriculture and infrastructure, that are precisely the kind of investments we think CDC should be making?

Edward Farquharson: Yes. Certainly on that last point, we, in fact, are co-financing the fertiliser plant project in Nigeria, so we would like to do a lot more. Our facilities seek to co-finance with other players and, as CDC moves more into direct investment, we will be seeing much, much more of that.

I think your earlier question was about equity.

Jeremy Lefroy: Yes.

Edward Farquharson: We do make equity type investments and those are made by our project
development companies—InfraCo Africa and InfraCo Asia—because equity, as opposed to debt, is the only way in which you can structure that sort of early stage funding into those sorts of projects. You cannot lend to projects that basically do not yet exist—they are a concept on paper. You are quite right: taking early stage risk requires the right financial instrument and that is equity. So potentially, yes, we will—in fact, we have sold on a number of those investments where we have made more than we invested, and we will recycle that into developing new projects.

The other facilities—for example, the Emerging Africa Infrastructure Fund—does not provide equity; it provides senior debt, so it will not be doing that. But what we are doing is looking at where we can provide a mix of equity and debt. One of the advantages of mezzanine finance, where you will have what we call an equity kicker, so you do take very high risks, but if things go really well, you can get a higher return as a result of that.

Q166 Jeremy Lefroy: Would it just be possible perhaps for this Committee to have a list of projects in the last two or three years financed by PIDG and the financials together with them, so that we can see the kind of work that has been done?
Edward Farquharson: Absolutely, yes. In fact, we publish all our projects on our website on our project charts, so that information is publicly available.

Jeremy Lefroy: It is all there.
Edward Farquharson: If there are any questions around that, I would be very happy to amplify those.

Q167 Mr McCann: Can I ask a broad question? What type of assistance is most helpful to the private sector in developing countries, in your opinion?
Diana Noble: We have seen a lot of evidence in the short time that I have been at CDC for the need for finance across the spectrum. One of the things I have been very surprised at is how quickly our new teams have been really overwhelmed with opportunities to look at. But then, of course, the statistics show how much there is a need for finance, again, across the spectrum of different types of companies.

The World Bank did a study that says that between a third and a half of all businesses, large as well as small, say access to finance is the major obstacle in sub-Saharan Africa and South Asia, and access to long-term finance at reasonable rates remains a particular problem. The difficulty that small companies have raising finance is no surprise. More of a surprise is the fact that a third of large African companies also struggle. But I do also agree with the comments made on the previous panel that the need is not just for money: it is for support; it is for human capital; it is for a broad array of things as well. To limit ourselves just to the need for capital is a bit short-sighted.

Q168 Mr McCann: But what would be the most popular? Would grants, loans, equity or technical assistance be top of the hit parade in terms of what the private sector is looking for in these areas?
Diana Noble: There is a need for all. The important thing is to target the right things at the right things, and to be genuinely market-led. One of the issues is that you have a spectrum of need here with different instruments for different things. It is a grey scale without a clear dividing line. We at CDC cover the whole spectrum, and a great deal of what we do is concessional in some sense. We provide capital to support market segments that other people find very difficult because the risks of failure are so high, such as supporting SME funds in hard countries and providing long-term debt for building manufacturing plants, for example, on terms that are different from those that commercial banks will provide.

Our equity can be more patient than fully commercial equity. But, of course, we have the whole portfolio to manage responsibly and so some of what we do also supports the development of fully-fledged, efficiently-working markets that efficiently price and allocate capital. It is a difficult balance. We want, as an organisation, to be additional and to provide concessional finance and we think it is a good thing. But, on the other hand, we do not want UK taxpayers' money to be used purely to enhance the returns of those in the private sector. That is the hard balance we live with every day, and it is not the balance that everyone offering concessional finance deals with very well.

Edward Farquharson: I agree with those comments, added to which I would say that one of the requirements is the need for local currency funding. Very often, our projects in particular generate revenue in local currency, so they do not want to be exposed to the mismatch between hard currency and local currency exchange rates. As a result of that, one of our facilities, GuarantCo, provides guarantees to enable local financial institutions and local investors to invest local money in projects, so that that exchange risk issue is taken away from the project.

I certainly go along with the points made about them obviously looking for longer tenors of finance because, if one thinks about it, a longer tenor of finance means that you can spread the cost of the project over a longer period of time, which makes it more affordable, particularly to poorer people. At the other extreme—extreme versions of concessionality—quite often, or sometimes, these projects need support in terms of capital subsidy or in terms of output-based performance payments. So there are these other tools...
that can be used to make projects affordable to the citizen, as well as obviously taking greater risks than the private sector alone is able or willing to take to make these projects happen.

Q170 Mr McCann: My final question would be: could DFID attract new investors in developing countries if, for example, they were prepared to absorb some of the risk by offering guarantees? What is your opinion on that?
Edward Farquharson: Following on from the comments made in the last session, they could, but it is a question really of how they do it and how best to do that. In a sense, in the infrastructure space, that is what they are using PIDG to do. Obviously you need to assess the credit risks and, of course, manage the portfolios afterwards once you have made guarantees available to projects; sometimes they get into trouble and so one needs credit skills to manage those sorts of situations. Using a specialist delivery vehicle like PIDG or CDC or whatever is the way to use DFID money to do that, rather than perhaps directly doing it with their own personnel.
Diana Noble: In theory, offering guarantees to the private sector to allow them to do more is a great idea. You do have to be careful about two things. You have to be careful that you are offering it into a market that clearly would not function without that guarantee, otherwise obviously you are just boosting people’s returns. There is great demand for it; I can guarantee you that. Secondly, concessional finance must help to create that market within a reasonably definable time frame, and the concession must have an exit strategy that is ideally underpinned with a sunset clause or something like that, which is explicit to all parties and applied in a disciplined way, so that if that functioning market is not happening in time, the money is withdrawn. Otherwise you support that for ever and then you are wasting taxpayers’ money.

Q171 Hugh Bayley: I see that you are providing some non-concessional loans. Is there not a danger that you will crowd out private finance and distort markets? Can you explain what sort of project you would provide non-concessional finance for? What is it in it for you and what is in it for the borrower?
Diana Noble: As I say, exactly defining what is concessional and what is not is not an exact science and, in a way, everything that we do has some concessionality around it. As I say, for everything we do, we sit around the table and say, “Is this better done by someone else?” or “What value-added are we bringing?”

Q172 Hugh Bayley: Can you give an example?
Diana Noble: Yes, I will give you an example. There is an investment we are about to make in India—I cannot mention it obviously because we have not made it yet—in a business that is creating the ability to link the manufacturers of apparel and goods with the market. It is effectively an e-commerce business, but it is a very early stage one that has huge losses and huge risks. If it is successful, the job creation, both in manufacturing and in delivery, will be enormous and game-changing. This is something where some financial people will take the risk, so you could look at it and say, “This is a financial investment.” We made the decision to get involved with it not only because of the job-creating ability, but because we have a particular emphasis on high quality jobs. We went to the company and said, “We want you to improve the quality of jobs down your supply chain, and we want to work with you to do that.” Now they could have said, “We are a commercial company. We don’t really mind. We just want to make the most money we can.” But they actually said, “Yes, we do want CDC. We’re really interested in doing that and we will work together with you to do this.” There is going to be a lot of work and a lot of effort to do it. So you could look at that investment and say that is concessional. I would say that it is hugely developmental, even though, from a capital-only view point, it is reasonably commercial.

Q173 Hugh Bayley: Earlier, when describing some of your projects, you went through a sort of gas to fertiliser project in Nigeria. I got that. But you also described what sounded to me like a paediatric training project in India, and I was rather surprised that that was something that a very well-endowed state like the Government of India was not doing itself.
Diana Noble: This is private sector, so this is not a Government-funded hospital. This is an entrepreneur-backed one, so it is an entrepreneur who has got it to a relatively early stage; he only has one site at the moment. He wants to take this centre of excellence and grow it over the next 10 years. He wants a partner who is not going to rush for the exit in three years, as a private equity group would do, and who is not going to say, “We don’t really care about quality of care; we want the returns to be very high.” They came to CDC and said, “You’re a really good partner for us in expanding this hospital across Southern India and treating mothers and children across India, but doing it in a high quality and patient capital way. That is why it is a really good fit for us. They want patient capital and there is not a lot of patient capital in India at the moment, where money is flooding out of and not into India.

Q174 Hugh Bayley: Where is the pro-poor dimension then? How is it improving the welfare of the children of landless peasants?
Diana Noble: The job-creation opportunity in hospitals covers the whole spectrum. Of course, you have highly trained doctors and nurses, but it goes right down the spectrum. The plan is to create 3,000 jobs. One of the things that our ex-ante tool does that I explained earlier is direct our capital to sectors that we think are more job-creating rather than less job-creating. Over time, you should see that if we had invested just in a basket across GDP equally, we would have created a certain amount of employment, but with this tool we will create much more. We think the need for jobs is so great in our countries that focusing on our priority sectors like manufacturing, agribusiness, infrastructure and including health and
education, which can have the same effect too, is going to be hugely developmental in time.

Q175 Hugh Bayley: Can I ask a wider question of both institutions? If DFID were to start to manage concessional loans without setting up a separate institution to do it, what skills would it need and what sort of people would it need to recruit to manage programmes of that kind?

Diana Noble: It is an obvious comment that running a development bank is very different from running an aid and government advice programme, which DFID is extremely good at.

Q176 Hugh Bayley: I am a bit slow. Why is it so very different? Please explain.

Diana Noble: It is hard to offer genuinely concessional finance strategically, which is what you have to do, and also to achieve the impact you are looking for over the long term and not lose your shirt. The margin for error is very low. If you lend at 0%, you clearly have a zero margin for error on failure. Everything has to get its money back for you not to lose your shirt. If you lend at 1%, you can take on a 10% failure rate. The write-down rates for banks in Europe over the past decade will have been a lot higher than 10% or 20%, so this is challenging stuff and you need high quality strategic and commercial skills to precisely execute strategy.

Edward Farquharson: Following on from that, we find that you can divide it down even further. If one looks at infrastructure, say, the skills needed for providing finance at the very early stage of a project's life are actually very different and distinct from the skills needed to make senior debt loans to projects. What is telling us is that there is a high degree of specialism going on across the project lifecycle in our sector. To have that in one institution, even if it is a private sector institution, would be quite challenging, so it comes to this point about specialism.

The only other point I would make about that is that we often talk about making loans and making investments. It is also about getting them back and, therefore, the skills needed to manage those portfolios and negotiate the issues where they arise during the life of the assets are equally important.

Q177 Chair: I want to ask a question and I want to ask it starkly. What we are looking at is how the development model is changing away from providing grants to governments and agencies for the poorest people in the poorest countries, which in the last 15 years has been the fundamental DFID model and it is very simple. We now find that more and more of the poorest people are not in the poorest countries. To take India as an example, we are ending our grant aid relationship, but there are still 400 million poor people, so we are exploring what different kinds of relationships we have. That is the context in which we mention the question “Should the UK have a development bank?” That is the question.

Before you answer that, the second thing to say is we get that you do not set up a development bank next week and have it operational. We accept that, if you are going to move away from grants to loans you are going to have to have some kind of loan window which you can manage more simply and more quickly. The evidence we have had is that those countries that set up that kind of loan operation ultimately transformed it into a development bank. The question is: should we be thinking about a UK development bank and, if so, what is the transition? If not, how would the mechanism work that still provides—if I can quote India as a shorthand—for a relationship with India that is moving away from a traditional grant aid relationship? That was a question for both ends.

Diana Noble: Maybe I can make some comments about things to think about. It might be helpful for Holger to talk about the evolving relationship in Germany between the different institutions, because that has been instructive. This is clearly a question for DFID, and I don’t know where they want to take their private sector development strategy. I do think a development bank could be an important part, but not obviously at the expense of retaining a significant aid budget. There will always be areas of public sector good that can only be funded through grants.

Edward Farquharson: Thoughts on execution are very important because execution is actually the key. It is so important to do it well, because otherwise you are wasting money that otherwise could support girls’ education or vaccination. These are programmes that DFID do incredibly well at the moment. I do think strategic focus matters. If a pool of money is clearly directed at a specific market failure, like PIDG or MIGA, which is another great example, then it can work very well. I think a scattergun do-anything mandate could do more harm than good.

The second point I would make is on pace. It really takes time—and we are living this at the moment—to scale up teams and strategies. The history of CDC shows that the biggest disasters happened when CDC rushed into a market too quickly, without really understanding what worked at small scale and before accelerating investment over time. One of the biggest challenges will be to resist the temptation to give a new team a big pot of money and incent them to spend it quickly.

The last thing is about the need for co-operation. I do not think it is for me to answer who should do this, but regardless of who does, we at CDC would be extremely co-operative, constructive and helpful. If it is outside CDC, though, it would be very important to have absolute clarity of mission between the two organisations to avoid confusing the market and creating unhealthy competition between teams. This comes back to strategic focus. I do not think it really works to have two organisations offering differently priced capital to the same clients.

Q178 Chair: I see that as an argument for saying that, if we did go down that avenue, we should develop it within CDC, which is an existing institution? I appreciate you having to keep a clear line of differentiation so you do not confuse the product. But you do have a quite a lot of expertise.

Diana Noble: It still could happen outside CDC, but there would need to be a huge amount of co-operation and clarity between the institutions.
Q179 Chair: If the view was to set up a separate institution, you could live with that as long as it worked co-operatively.
Diana Noble: Of course.

Q180 Chair: From a PIDG point of view, is it relevant to you? Would it matter either way that DFID is developing loans and potentially a financial institution like a bank, going more than a year or two ahead, obviously?
Edward Farquharson: Yes. The point about being very clear about its mission is important. For example, in a middle income country like India, you could be asking two questions. You could be asking the question about, “Should we be solving the problem about cyclical and the constant availability of very long-term finance for infrastructure projects, which particularly matter to us?” You see very successful examples in the world like the European Investment Bank operating within Europe doing that. We saw that in 2008 and 2009, how they stepped into the breach to ensure that there was a continued flow of long-term finance. You could see that sort of issue in a country like India. Indeed, India does have institutions like IIIFCL and so on. There are a lot of acronyms, but there are institutions focused on trying to mobilise long-term finance within the domestic market. Then you could look at the other area, and that is that it is perhaps not so much a focus on providing stable long-term finance but about doing difficult projects in difficult sectors in difficult parts of India. Indeed, a focus that we have in India is on the eight poorest DFID states, so we do not do anything outside of those states. In which case, that institution would have more skill sets around making these very difficult economic decisions about concessionality, and less about only financial structuring how you catalyse long-term bond financing or private sector debt financing.

Q181 Chair: Both of you are talking about either private sector funding or mixed funding like joint ventures. Part of the idea is that we stop giving grant aid to India, but we continue to work in a development co-operative fashion and provide technical assistance. When the programmes prove workable you can then offer a long-term loan to help deliver those projects either to the Indian Government or a provincial government, which would be a role that a bank could perform. Is that model—
Edward Farquharson: I suppose the point I would make is one of leverage. To make sure that that money goes as far as it possibly can we would have to think very carefully about the capital structure and the most efficient way in which it can catalyse other sources of long-term funding.

Q182 Chair: That is terribly helpful. Thank you very much. We have an open mind. This is a long-term review and we are really genuinely trying to get different views. You probably heard from a previous panel that some people think we should not even go there and DFID should just stick to what it has, but I keep coming back to places like India and thinking, “Well, that leaves us with no relationship with India”. CDC has a relationship, but DFID would not.
Diana Noble: We do.

Q183 Jeremy Lefroy: I wanted to come on now to how overseas development assistance is calculated and the impact that has. It has obviously become even more of an issue, given the Government’s continued intention to fulfil the target of 0.7% of GNI as ODA. I always point out the problem back in 2006 when, as a result of successful investment by CDC in Celtel and the money coming back, British ODA fell quite substantially. You have the problem of a success by CDC resulting in something that might give a future Government a problem because by the timing of that sale of an investment—perhaps a particularly large one—you suddenly end up falling below 0.7% and breaking the law because the last thing you want to do is suddenly reinvest that money immediately in order to make up the 0.7% again. We will go on to talk about loans afterwards, which is another area of contention, but I would like to first ask how would you see that being tackled in the definition of ODA? Do you think that currency changes in CDC should be taken out of the definition of ODA because this is actually an incentive to make bad investments quickly when you have succeeded?
Diana Noble: Yes, you are absolutely right. This is a difficult topic, and we in the UK are not alone in asking questions on how this should work in a world where capital is being provided in different forms than grants. I do understand the Government is going through a process of assuring that its own development flows are correctly scored with the OECD DAC classification system at the moment. I think you are right to quote the Celtel example. Developmentally that was fantastic. Huge employment was created, not just in direct jobs but in the whole ecosystem in Africa, and mobile phones have been transformative for the lives of the poor in many profound ways. It was not an easy investment; it took a long time and there were many bumps along the way. Ultimately it made this fantastic financial return, but yet when CDC sold it, it crystallised the gain as negative aid for ODA. I look at that and I wonder why a great developmental story should penalise DFID as our shareholder. It is perverse. Conversations are going on outside this room; I do not know where they will end up, but it is not helpful in the relationship between CDC and DFID to have that kind of perverse incentive.

Q184 Jeremy Lefroy: The other area is concessional loans, where the definition of concessional loans is indeed contentious. The provision of concessional loans by certain countries has, to some extent—provided the value of those concessional loans is increasing year-on-year—been one way of meeting an ODA target or going towards meeting an ODA target without actually affecting the Government’s national budget, because it is able to raise funds on the market in order to make those concessional loans. How would you see a true definition of concessional loans in terms of ODA and how would you see these kinds of loans that are coming from funds raised on the market rather
Holger Rothenbusch: That is the model that France and Germany in particular have applied. They do generate quite a significant amount of ODA. In terms of the structure, it is compliant with the current calculation of ODA. If the use of funds in terms of the projects that are being financed is appropriate, I personally think in principle that is something that can be done. It does lead to increased indebtedness of Government ultimately because, obviously, the funds that are being raised in the market have to be repaid. That is ultimately increasing debt, but as long as the definition is such, by structuring loans such that budget funds are used to reduce the prices or reduce the interest rate on those loans, it can lead to ODA.

Q185 Jeremy Lefroy: In the end, do you not think it is going to create an unsustainable bubble in debt? If you look at the Japanese example where they have something like $100 billion outstanding, it is great in terms of the concessional lending that they have done, but at some point if that debt is repaid or the increase in debt does not go on year on year and the repayments therefore come and push that down, it will have a very substantial effect on ODA as far as Japan is concerned and, indeed, Germany and France. They then the task of reaching the 0.7%, which they all committed to, is made absolutely impossible. Is that not a bubble?

Holger Rothenbusch: I would agree. Ultimately, that is a political question that would need to be answered: what is the key objective you want to achieve? Is the 0.7% target so important or is managing debt levels more important?

Q186 Jeremy Lefroy: What we are saying at the moment is that potentially the 0.7% target, which all parties in this country subscribe to, encourages countries to game the way in which they do their international development because, particularly at a time when countries’ budgets are under such pressure, the temptation of saying “Well, it’s not coming out of my Government’s budget; it’s actually money that I’ve raised on the market” is very great. In the end, that is going to lead to the 0.7% target becoming almost meaningless because you have more than two completely different sources of finance being included in the same target. Therefore, Britain, by religiously sticking to 0.7%, with all the potential problems that perhaps the CDF might cause if it is successful in the future—which we hope it is—is doing it in one way and other countries are doing it in a completely different way.

Holger Rothenbusch: Yes, I would agree.

Q187 Jeremy Lefroy: Is there any solution to that? Should we change the definition of ODA as a result and exclude concessional finance? Should we just say the 0.7% has to be nothing to do with equity and concessional finance, but only grants, or only, in concessional finance, that little bit of it that you can identify as effectively a grant?

Holger Rothenbusch: My personal view is that is one possibility to do. Quite honestly, I wonder to which extent the notion around volumes of capital being deployed in certain countries or to certain countries is so relevant over the next five to 10 years’ time. We have touched on before here that it is not only capital that is required. It is also supportive technical assistance; it is the effectiveness of the intervention that is being pursued by the different entities rather than the amount of dollars, pounds or euros that you can ultimately put on your scorecard. I would definitely say that there is a bigger conversation to be had rather than a fixation on a specific number, which will always lead to some gaming one way or the other. As soon as you set up new rules, you will have a new game that will be designed to circumvent that one. There is a qualitative debate to be had rather than a quantitative one.

Q188 Chair: The previous panel were of the view that DFID could provide private sector loans effectively; it has the capacity, but it would require some cultural change. I do not think this is a question that need detain us very long, but, firstly, do you agree? Also, what would need to be done to manage that, given that by definition you are talking about a larger number of smaller transactions, and also to do it in a way that did cause adverse competition, which is what you have mentioned in the evidence? What would be required to ensure that it did not provide unfair competition and that it was manageable within the Department, assuming you agree with the previous panel that they thought it was possible that DFID could do that?

Diana Noble: I would just go back to the comments I made that the team would need to have a really clear strategic focus and be able to be market led so it can really understand how it is providing the funds. It would need to have a commercial core to it so that it could apply those funds with real discipline, accepting that it is trying to limit the failure rate as well as get money out of the door. It would be very helpful not to have volume targets in the early days as well and to accept that this would take some time, because there is cultural change required; hiring teams and bedding those teams down takes time. Those are the key points.

Edward Farquharson: We are grappling with a sort of similar sort of problem in the establishment of Green Africa Power, which is going to provide long-term patient equity to renewable projects in Africa. It has to make sure in its judgment that it is supplying capital to those projects that really need it and ones that cannot turn to the private sector alone to do. The point I would draw from that is, in that thinking, it would be important to have both public and private sector or commercial skills so that, when you are making that judgment about whether applying finance is additional or not, that one is fully au fait with the conditions in the market to make that judgment. Is one just subsidising the private sector or is one actually addressing the market failure? It will require that skill as well.

Q189 Chair: Presumably from a management point of view, you would need agencies. You would not be
able to do it all in-house. Indeed, you do not do it all in-house.

Diana Noble: That is right. You can obviously do more if you build relationships with people who have that knowledge already, and you can go faster too. In that key decision of buy or build, I would buy quite a lot before I build.

Q 100 Jeremy Lefroy: Some NGOs have argued that reintroducing bilateral concessional loans could impose an unsustainable debt burden on developing countries. We all remember, 15 years ago, the campaigns to relieve them of that. Diana, I realise that you talked about any future venture into this area needing to be patient and long term, but what would you say to their argument that that might make it a bad thing to reintroduce such concessional loans?

Diana Noble: If I am not wrong, they are talking about the public sector.

Jeremy Lefroy: Yes. It will be in the public sector.

Diana Noble: I am not sure I am well qualified to talk about that part of the market. It is an enormous market and I have heard their concerns, but do I not think I can address them?

Edward Farquharson: My one comment on that would be it highlights the importance of investing in productive enterprises rather than destructive enterprises. Businesses that contribute to economic growth are obviously going to help a country maintain its position when it comes to debt sustainability, because I think one found that one of the causes of the debt crisis in the past has been poor investment in the wrong sorts of enterprises and activities. Therefore, the selection of businesses that one wishes to support is obviously very important to avoid that.

Diana Noble: If I can just supplement that point, in the private sector the skills that are required here are to look at something that inherently does not make money today—it is uncommercial today, because otherwise it does not need concessional finance—but be able to think about what your money can do and what can be created in five to 10 years. That is a pretty high skill, to be able to judge whether your money is going to the right things and not the wrong things. I would definitely advocate thinking very carefully about the skills on the team that are necessary to deliver this plan.

Q 191 Chair: I have one slightly contentious question about transparency. There are two issues, one of which you would expect. I was just interested to note that the International Aid Transparency Index scored DFID "good" at 91.3% and CDC "poor" at 22.5%. How do you react to that? Before you do, we and other people have put the second question, which is obviously the use of so-called tax havens in your management policy. We have had this discussion before, but has it developed?

Diana Noble: Let me start on the transparency point. We very clearly seek to be as open and transparent as possible, subject to the confines of commercial confidentiality and the Data Protection Act. As a result, we publish information on the businesses, our capital supports, the fund managers we work with and the funds investing our capital. We publish a range of corporate data, including data on staff remuneration and operating costs. We have made considerable steps forward on this in the past few years. We have also become a signatory to the IATI, International Aid Transparency Initiative, in 2011; we were the first bilateral DFI to do it, and we started publishing data to the registry. We are continuing to work closely with IATI to ensure that it is able to capture data that is relevant both for institutions providing capital to the private sector and to public sector entities.

On the specific Publish What You Fund index rating, there were some fundamental problems with the report, from our point of view. We scored lower than other organisations surveyed by the Aid Transparency Index, and in part that reflects the difficulty of using what is a donor-oriented questionnaire to assess CDC’s private sector investment operations. Let me give you an example: we were marked down for not including budgets for which countries and which sectors, or the forward-planning budgets of where our capital is going to go.

Chair: Because you do not operate like that.

Diana Noble: We simply do not operate like that and nor should we operate like that. That would not be a prudent way to go. That is only one of a number of examples. The DFI peer group they selected for comparison to us includes IFC, IADB, EBRD, EIB, KfW and Korea’s EDCF. A lot of these are organisations with considerably different funding models, governance arrangements, products, clients, resources and scale to us. Not one of the bilateral European DFIs that we consider to be our closest peers was included in the survey. We have discussed this all at length with Publish What You Fund, and they told us earlier this year that we will not be included in the index for 2013, but we are going to work with them to develop a parallel methodology that takes account of DFIs’ different operating constraints.

Q 192 Chair: So you hope your rating will improve on that after that discussion.

Diana Noble: We hope that we will be accurately represented by them, but according to what we do. This is not about changing things just for us; we would like to change it for the other DFIs as well.

Q 193 Chair: Tax havens?

Diana Noble: Would you like to answer that one first and then come back to me?

Edward Farquharson: From a DFID perspective on tax havens, we have an operating policy that requires all PIDG participants to take account of the classification of tax jurisdictions, and in fact we are just about to release our operating policy on that. One of the practical challenges around that is that publication of what tax havens are not acceptable is a politically difficult thing for some of the Governments to actually issue. The practical problem it presents for us is giving guidance to our facilities as to what they should avoid. Nevertheless, we have developed a mechanism that is likely to classify the areas where we are very happy and, if they want to stray from that, then that needs to be taken up with the funding donors. It is not a significant issue for us because our
facilities are aware about the sensitivity of it, but they do work with the private sector and the private sector operates through some of these jurisdictions.

**Diana Noble:** From CDC’s perspective, our mission statement is to support the building of businesses throughout Africa and South Asia. That forms the tax basis for these countries as they graduate from aid. We require that all businesses pay the taxes that are required for them in the countries where they operate. In 2012, that resulted in £2.6 billion of taxes to local governments, up from £2.2 billion the year before. We have made a decision as we start investing directly not to do any of our direct investments through tax havens, unless there is a really strong reason and we are investing with someone whose mind we cannot change. Primarily, our intention, when we invest directly, is to invest directly. On the funds model, we welcome the decision taken by the G8 recently to develop a truly global model for multilateral and bilateral automatic tax information exchange. We and DFID are looking for opportunities to support countries on the implementation of that new global standard. Once that standard has been adopted, we will only invest through those countries that have implemented or are working towards the implementation of that standard, so I think this is a big step forward. As our 100% shareholder, DFID will monitor the implementation of this policy on the part of HMG. In time, we would like our funds business to invest not through offshore centres, but the countries we invest in are simply not ready for it. We have examples—and we will share them with the Committee in writing if you are interested—of funds where DFIs have tried manfully to set up those funds in African countries. There is one particular example where an SME fund was attempted to be set up in Mozambique, and after two years of to-ing and fro-ing with the authorities they gave up. Not a penny went to SMEs in those countries because the authorities were not really ready with all the mechanisms to set funds up. When you go through offshore centres, they are, so there is a really strong reason why we continue doing what we do.

**Q 194 Chair:** I think we would appreciate examples, because members of the Committee quite often get asked what they feel about it.

**Diana Noble:** Yes, of course. We can provide those, and they are quite powerful, actually.

**Q 195 Jeremy Lefroy:** Just on that, I have been working with an organisation I set up with colleagues called Equity for Africa, which was a charity and is now a social impact fund. It has encountered the same problem of the mechanisms to do this. One approach we have taken is to work with the authorities locally to try and help them to get the legislation in place so they can have those locally rather than all needing to go through offshore facilities. Do you do that? Do you work with authorities and say, “We would like to set up an investment fund locally in your country. At the moment the legal framework is not there; can we work with you to get that framework in place, which would be of benefit to you and to other investors who want to come in?” rather than just saying, “There’s nothing here so we’d better go elsewhere”?

**Diana Noble:** No, I think that is right. Work does need to be put in. It is actually probably more suited to DFID and its advisory teams who are closer to Governments on regulation and legislative areas than us. We would very much welcome that.

**Q 196 Jeremy Lefroy:** CDC has a lot of skills and expertise in this area. Why don’t you do work with the private sector and the private sector facilities are aware about the sensitivity of it, but they do work with the local governments and say, “We would like to set up an investment fund locally in your country. At the moment the legal framework is not there; can we work with you to get that framework in place, which would be of benefit to you and to other investors who want to come in?”

**Diana Noble:** Of course. We would support them, help them and tell them what we needed, but the actual heavy lifting in terms of the advice and guidance would be more suitably within DFID.

**Q 197 Chair:** We are in an era where everybody wants to know the impact of the development expenditure. The Government has set up the Independent Commission for Aid Impact. I have just noticed that, generally speaking, CDC tends to talk in terms of financial returns, although I accept that it is changing, and jobs is obviously a focus. PIDG is talking about leverage and so forth. These are all perfectly valid things, but do you think there could be done to focus—it needs to be a slightly broader base than that—to say what the development impact was? Do you think the tools could be improved and made a little bit more sophisticated to measure that?

**Diana Noble:** Yes, definitely. This is work in progress for us. I described earlier how we now direct capital towards opportunities that we believe will have more impact over time, especially job creation, and we have a robust tool to support that. Now, we are working on how to measure the actual impact of our investments in a way that communicates clearly what our capital is achieving, but also in a way that helps us to be smarter, based on actual learning of what works and what does not work. We have recently hired a Director of Development Impact, which is the first time that CDC has had someone with this title, to design this for us. This is work in progress, and we hope early next year we will be able to make this more public. That is not to say we do nothing now in terms of measuring what we do. We actually do a lot. Since 2008, we have evaluated the performance of all our fund investments after five years and 10 years. Half of those we do ourselves and half of those we use external consultants. This evaluation uses a framework based on the IFC’s highly respected DOTS, which is the Development Outcome Tracking System, and those evaluations are scrutinised by the board’s development committee, and the outcomes are also reviewed by DFID. The exercise that the new director is undertaking will inevitably have its focus on job creation. That is not just crude numbers, but we hope job quality as well; not just direct jobs, but also indirect jobs in the supply chain and what IFC call “induced jobs”, which are jobs created in time as a result of new infrastructure that you put in place, for example.

He is working alongside the other DFIs and IFIs in this endeavour, because we are a strong believer in the harmonisation of indicators. That is firstly so that we do not drive management teams that are doing really hard jobs in really difficult places crazy with...
different measures that are trying to achieve the same thing, but secondly so that we can genuinely share our performance data, which I think would be to the benefit of all. We are aiming to have something in place early next year, and we are happy to share it.

**Q198 Chair:** Thank you. Does PIDG have something similar?

**Edward Farquharson:** Our development impact tool is something we are actually very proud of, because we have been operating it for quite a number of years now. We have four quantitative indicators: we have talked about leverage, but we measure jobs, we measure fiscal impact and in fact we measure the amount of taxes that our projects are going to be paying as part of that. We also measure the number of people that have access to new or improved infrastructure.

In terms of where we are going next with this, Diana mentioned indicator harmonisation. It is really important that we do not create a burden on recipients of support having to report in different ways to different donors, so we are part of the harmonisation group working with DFIs to try and harmonise that as much as we can. We have recently taken further steps to report on the gender impact of our projects. When we look at the number of people who get new or improved infrastructure and the number of jobs, we are now disaggregating that into men, women, boys and girls so that we can report on that. We are also reporting on climate change impact. We have developed a tool with the IFC that enables us to classify all of our projects in terms of the impact that each one of those will have on climate. We have recently concluded a study on job impact. It used as a case study a 13MW hydropower project in Uganda, where we looked at what the indirect impact of our investment was on jobs and the induced impact of investment, not just direct, but the secondary effects. We have recently published that and we are going to take it further.

**Chair:** That is very helpful, and we look forward to hearing more of those developments. Everybody needs to know, effectively, what the money delivered in terms of development. I agree with you that, as long as it is done in a way that is consistent and not so complicated that it is meaningless, that is a very helpful focus. The other point that was made, of course, is it is not just about jobs; it may be about improved livelihoods or incomes. I do not know if that is something you would build into it. Clearly, you may not create jobs, but you may lift people out of poverty because their income levels go up. I think most of us would regard that as a legitimate measure of impact. Can I thank you very much? As I explained at the beginning, this short return of Parliament is giving us a bit of pressure, so colleagues have been in and out, but I think it has been a very helpful session.

**Jeremy Lefroy:** I just want to go back to something from the previous panel, because I think I was probably being a bit unfair to DFID about agricultural extension services and their attitude towards it. Having re-read their reply, they are still very sceptical about public-funded extension services, and I would have a slight issue with that. But they are much more open to agricultural extension services in general, so I do not want to give the impression that DFID is totally anti them.

**Chair:** The impression I have had, when we have discussed this with DFID before, is that they are worried about the amount of people involved. They do not want to feel as though it is their responsibility. I suspect that is part of it. We can exchange our views with them, but thank you for putting that on the record. Thank you for coming in. As I said, this is a long-term report. Some of the Committee is off to Washington and Brazil this week and next week, both to discuss these issues with the World Bank and what they think about how DFID can develop, and also to look at what donors and indeed the Brazilian Government and other agencies are doing, just because DFID has no engagement of any significance in Brazil, and yet lots of ideas seem to be coming out of it. Just to give you a flavour, these are the kinds of threads we are drawing together. Again, as I said to the other panel, if on reflection there are any thoughts you can add, other than the things you have said you can send to us, please feel free to get in touch afterwards. I will be very happy to hear from you. Thank you very much indeed for coming in.
Wednesday 9 October 2013

Members present:
Sir Malcolm Bruce (Chair)
Hugh Bayley
Fiona Bruce
Richard Burden
Fabian Hamilton
Pauline Latham
Mr Michael Mccann
Fiona O'Donnell
Chris White

Examination of Witnesses

Witnesses: Rt Hon Justine Greening MP, Secretary of State for International Development, Susanna Moorehead, Director, West and Southern Africa, Department for International Development, and Professor Stefan Dercon, Chief Economist, DFID, gave evidence.

Q199 Chair: Good morning, Secretary of State, and welcome once again to a session of the International Development Committee. Thank you also for agreeing to do this in two parts: a relatively short focus on the South African decision; and then obviously the main consideration of the future of development finance, in particular.

We have obviously seen some of the ebb and flow of the comments about that decision, and indeed the South African Minister of Finance made some reference to the timing being relevant to local elections in England. I think I can anticipate your response, but how do you respond and, perhaps more to the point, why did you make the announcement at that particular time? Sorry, perhaps you should introduce your colleague.

Justine Greening: Thank you. Let me start by introducing Susanna Moorehead, one of our lead officials in DFID, who will be here for the South African element of this evidence session. We will later be joined by Stefan Dercon, Chief Economist, for the future of development session.

In relation to your first question, as you will be aware, following the Bilateral Aid Review shortly after the election, we began to look at whether we should transition out of South Africa. That process took place over a number of months, and we ultimately made the final announcement of our intention on the date that we had planned to.

Q200 Chair: There was no significance, and the fact that there were local elections, you would say, was not even in your mind.

Justine Greening: We felt it was sensible to make the announcement as part of a speech, at The Times CEO Africa conference, which was all about development within Africa and the growing economic power of Africa as a continent. It seemed quite a good match between the decision we were announcing and the audience we could announce it in front of.

Q201 Chair: That may well be the case, but there was a reaction. The South African statement said that you had agreed, at the Minister of Finance's request, to leave out the reference to their agreement to end bilateral aid. He then complained he was astonished that was in the announcement they had agreed. He said they had not agreed, and that you had agreed not to say that they had.

Justine Greening: This was a decision for the UK Government, and I cannot speak on behalf of any Government other than my own, suffice it to say that we had had discussions over a period of months, within Whitehall of course, but within the South African Government, the Ministry of Finance, Foreign Affairs, at ministerial level, and my predecessor and I at official level. We finally announced the decision on 30 April.

The other point I would make is that we have just had our biannual bilateral forum with South Africa, and the communiqué that emerged from those discussions showed that we continue to have a very strong relationship with South Africa, and indeed I had a very constructive meeting with Minister Gordhan, the Finance Minister, around how we can now put into place the detail of this transitioning relationship from an aid perspective.

Q202 Chair: Do you feel that relations are back on a positive footing. Clearly there was a period where there was public disagreement, but you have had that meeting; you say that was constructive. Do you feel now that the relationship between you and the South African Government is back on a positive footing?

Justine Greening: Both South Africa and the UK have been clear that we have a strong, dependable and robust relationship. It is born out of very close links between the two countries, not least the fact that the UK is the largest source of foreign direct investment in South Africa, and indeed South Africa is the 24th-largest trading partner that we have as a country, so it has a significance to us and to them. The bilateral forum was a very good opportunity for us to take stock of that relationship and start to plan how we want to develop it going forward.

As part of that, we had a constructive meeting with Minister Gordhan of the Finance Ministry, and our teams can now work together to transition that relationship post-2015 into a relationship based on technical assistance, programmes that we can work together on regionally and, of course, trying to co-operate on the global development agenda too, within which South Africa plays an increasingly important part.

Chair: We might explore that a little bit later. I am going to bring in a couple of supplementaries.
Q203 Mr McCann: Good morning, Secretary of State. You explained that the decision had been mulled over for some time before being made. Was there any political discussion or discussion with officials that the timing of the decision could be misconstrued?

Justine Greening: We had essentially, as with any Government decision, had a process to look at what the substance of that decision should be. As I said, that began after the Bilateral Aid Review that took place when we came into Government, and culminated with the decision that we needed to transition our relationship on to a basis that reflected South Africa’s emergence as a major player within the African economy overall, but also more broadly as one of the G20 nations and a member of the BRICS, obviously. We announced the decision when we had always planned to, and it is like I say: formally since then, we had the chance to have our bilateral forum a couple of months ago, and the communiqué is pretty exhaustive in setting out what I think both countries feel is a very productive and constructive relationship.

Q204 Fiona O’Donnell: Good morning, Secretary of State. I am pleased to see you still here this morning in your chair. Can I just clarify, following on from the Chair’s first question, did the Minister of Finance ask you not to include, in the statement, that he had agreed to ending bilateral aid? If he did, what was your understanding of why he made that request?

Justine Greening: You would have to ask him about understanding of why he made that request?

Justine Greening: If you look at the bilateral forum communiqué, it is very clear that we are moving on to a relationship that is based on technical expertise and co-operating at a regional level. That is something that we are planning to do.

Q205 Fiona O’Donnell: I am still not clear. Are you saying that he did not make the request to you? I do not expect you to answer for any statements that he made around that time, but, in terms of the conversations that you and your officials had with him, did he make that request?

Justine Greening: I do not think I am going to go into what were essentially private discussions at ministerial level but, as I have said before, ultimately, this was a decision for the UK Government to take in relation to how we wanted to target taxpayer money on this aim of reducing extreme poverty. It was the culmination of a relatively long process over a period of months that had operated at a number of different levels—official level and ministerial level—and resulted in us, as we had planned at a conference, which was one that was pertinent to the issue that we were discussing, announcing this decision that we would end financial aid to South Africa and, indeed, transition to a development relationship that we felt was much more appropriate for where South Africa is as a country. If you look at the bilateral forum communiqué, it is very clear that we now have a good agenda ahead of us. It is one that, as I said to the Chair before, reflects where South Africa is as a country today.

Q206 Hugh Bayley: When you issued your press statement to announce this decision, Secretary of State, you said in words attributed to you, “I have agreed with my South African counterparts that South Africa is now in a position to fund its own development.” Do you believe that was an accurate statement and do you stand by that now?

Justine Greening: Yes, I do.

Hugh Bayley: You agreed with the South Africans and they agreed with you.

Justine Greening: If you look at the bilateral forum communiqué, it is very clear that we are moving on to a relationship that is based on technical expertise and co-operating at a regional level. That is something that we are planning to do.

Q207 Hugh Bayley: That is a separate issue. Do you stand by this statement that you had agreed with your South African counterparts? The reason I ask the question is the South African Government has given us evidence and they say this: “When our Minister of Finance … saw Ms Greening’s statement prior to her announcement, it was pointed out to the Secretary of State that any reference to an agreement with the new strategy would be incorrect. She agreed to leave out the reference to such an agreement. It was, therefore, shocking to hear the announcement.” Why did you put in your announcement that there was an agreement when the South African Government believes that there was no agreement?

Justine Greening: As I said, this was something we had discussed with the Government of South Africa at a number of levels.

Hugh Bayley: Discussed—but had it been agreed? This is the question.

Justine Greening: I am just finishing the answer. We had discussed it for a number of months at different levels of the Government and, as far as we were concerned—and again I can only speak on behalf of our Government—Hugh Bayley: Here you are speaking on behalf of the South African Government, with the greatest respect. You say that you have agreed a certain course of action with them.

Justine Greening: It would help me to understand the premise of your question and the relevance of it in relation to the decision I took.

Hugh Bayley: The premise of the question is this: the South African Government expressed shock and surprise at your announcement, because you said that they had agreed to something to which they had not agreed. I am trying to get to the bottom of how it was that you made a statement about having agreed something, with a very important bilateral partner of Britain, which they had to repudiate.

Justine Greening: A gain, I think that is a question for them. As I said, we had a long and exhaustive discussion with the South African Government around what we were proposing to do and, indeed, we announced it on the date that we had proposed to announce it on. In relation to the immediate response
that you have just set out, you would probably need to direct your question to them, rather than me. All I can say is that I think the more exhaustive and full assessment of the two countries’ relationships, which is probably what you are driving at ultimately, is clearly set out in the bilateral forum communiqué. My sense is that, if the question really is what the state of the relationship is, the communiqué gives a very good and rounded status of the relationship.

Q 208 Hugh Bayley: That is an important question, but it was not the question I was asking you. You say the question, or at least part of the question, that I am asking you—whether this statement of policy was jointly agreed—is a matter that needs to be put to the South Africa Government. It is a matter that this Committee has put to the South African Government, and they say this, “During The Times CEO Africa summit, a possibility of a joint statement was raised by Secretary Greening’s office, but officials of the two countries/departments could not agree on the joint statement.” Since you had tried to make a joint statement, they had said they could not agree with what you wanted to put in a joint statement. Why did you then put out a statement of your own saying there had been a joint agreement?

Justine Greening: My recollection of the time was that we had reached a common position as to what our future development relationship would be.

Hugh Bayley: They say they directly said to you that they could not agree to a joint statement.

Justine Greening: That is reiterated in the bilateral forum agreement. As I said, the constructive meeting I had recently with the Finance Minister, Pravin Gordhan, reiterated that perspective that I have just given you.

Q 209 Hugh Bayley: I am pleased that the relationship is getting back together. That is very important for both of our countries, and I am glad to hear that. Given that you were seeking a joint agreement and it was clear, from a South African point of view, that there was no agreement and, therefore, a joint statement could not be made, we come back to the question of why you decided to put out a statement then, just before the election, which The Times of the UK interpreted as being an election ploy. Why did you do it then rather than continuing to talk, until such time as you did have a joint agreement, say in September, when you had had this meeting?

Justine Greening: I cannot add anything further than the fact that we had had discussions with the South African Government as to our intentions and the need to move to a more technical-assistance-based relationship, from a development perspective. Many people feel that is a sensible move to make. Indeed, it is one that is set out in the bilateral forum communiqué. We made the announcement when we had planned to. As I said, there was some sense in making it at this Africa-economic-development-focused conference. Really, I cannot add anything more to that. You are asking me why maybe a press release statement was made by somebody who is not me. The question ultimately has to be to them. All I can do is give you the perspective and the facts as I see them, which was a decision around how we spend taxpayers’ money and target it on countries to help them tackle extreme poverty, a process that had begun after the Bilateral Aid Review and was discussed, at ministerial and official level, by both my predecessor and me. It was ultimately announced when we planned to announce it, at a conference that was very much related to the development of Africa economically, which absolutely underpinned part of the rationale as to why we felt it was a good time to transition our relationship with South Africa. That all seemed a sensible approach to what was, I think, a sensible decision.

Indeed, the bilateral forum communiqué, which we issued just a few months ago, very clearly sets out a full, constructive and developing relationship between the UK and South Africa. That will continue, not just in relation to development but, far more broadly, on issues of trade and investment. That is in both countries’ interest. That is what you can see from those discussions that we had just a few weeks ago. They were very positive, and I am sure that we can continue to develop our relationship.

Q 210 Hugh Bayley: One final question, if I may: I remember from my time as a minister, we were under very strict instructions not to make major policy announcements close to elections, because to do so is in contravention of the Ministerial Code. Since this was a matter that one national newspaper at least decided was an attempt to swing opinion in the local elections, why on earth did you decide to put this statement out before the elections, in breach of the Ministerial Code, rather than a few days later?

Justine Greening: I have explained the nature of why it made sense to make the announcement when we did. In terms of the size of the announcement, it was actually part of a general transitioning of our development portfolio, which we no doubt will come on to talk about more broadly. It followed, similarly, an announcement of transitioning our development approach with India. Interestingly, on average over recent years, bilateral development assistance to South Africa has been £19 million. We can contrast that with the level of investment not only in other countries in Africa but with countries like Pakistan, for example.

Hugh Bayley: Surely you are not saying it was small, so it does not matter.

Justine Greening: No, I am not.

Chair: That is part of our next evidence session.

Justine Greening: If I can just finish, what I am saying is that level of £19 million was one that had reduced over recent years, so that transition, in many respects, had already begun. It was the end of a long process of discussion, at ministerial and official level, and an announcement that took place at a sensible moment, exactly when we had planned.

Q 211 Richard Burden: We will ask you a few more questions in relation to the future of the development relationship between the two countries—how you see that and some of the issues around that. Just staying for a moment, though, on the process that led up to
the statement being made and the statement itself being made, you have heard our questions here. Are there any lessons that you draw from what happened, the way it happened, the way the statements came out, the timing of the statements, and would you do exactly the same again or would you do it at all differently in the future?

**Justine Greening:** It is right to take proactive decisions about how we target our development spend to get the most impact, in terms of reducing extreme poverty; on behalf of the taxpayer. We have to get on with that process. I do not think we should rush it and reach pre-emptive decisions but, when we have reached a conclusion about what the way forward will be, then we need to implement that, and that is precisely what we are doing now.

As I said, it was something that ultimately began as a process following the Bilateral Aid Review. It is very important for the taxpayer that they see ministers actively deciding to change our portfolio of where we invest money when the facts on the ground are changing, and when we feel we need to continue to change our spend, in order to target it effectively. That is what we were doing. That is what people rightly expect us to do. I have to get on with my job of making sure we get the most impact out of every single pound.

**Q212 Richard Burden:** This is not on the substance of the decision but, if you had the time again, you are saying that you would not do anything any differently from the way it was done, how it was announced and why it was announced in that announcement.

**Justine Greening:** From a UK Government process perspective, we absolutely went through due process. We had the relevant discussions at the relevant levels in Government across the relevant different departments in the South African Government. We took a sensible decision at what event might be a good one to announce it at, mainly because, from our perspective, we saw it as a very positive transition that reflected the great progress that South Africa has made in its development. Therefore, there was an absolute logic as to how we finished off this process and then announced it.

**Chair:** Perhaps we can move to a more forward-looking dimension.

**Q213 Fiona Bruce:** Good morning, Secretary of State. I have some questions about the impact on civil society in South Africa of cutting our bilateral aid. There have been concerns expressed that this is going to inhibit civil society from holding the South African Government to account. We would be interested in your response to that. Also, how do you see that those civil society organisations are going to replace their funding, now that it will no longer come from DFID?

**Justine Greening:** It is fair to say that our transition towards a relationship based on more technical assistance than financial aid does not preclude us from continuing our work with civil society. Clearly, it has had a huge role to play in many of the issues that DFID has worked with the South African Government on over the years, including the health agenda, so I do not think the transitioned relationship precludes us at all from working with civil society.

**Q214 Fiona Bruce:** That is very interesting to hear. Can we also ask about working with women and girls? Obviously, that is at the heart of DFID’s work. We are interested to know why we are leaving a country with one of the world’s highest rates of sexual violence and HIV. What can be done about that?

**Justine Greening:** There are probably two points to make. In relation to the transitioning relationship, we look very closely at not only what the levels of extreme poverty are, for example, but also the prospects of growth and then a country’s ability to continue to lift people out of poverty. In relation to the subject that you have raised, I think the UK Government will continue to play what I have seen to be a leading role, particularly in relation to the broad women and girls agenda, but especially in relation to violence. Indeed, I work hand in hand with the Foreign Secretary, who has led what I think has been an extremely successful international initiative combating violence against women in conflict.

As the Committee will be aware, I am myself holding a Call To Action conference in relation to violence against women in emergency situations. That is part of a broader push by this Government to do what we can to raise this agenda of the totally unacceptable and often routine violence that takes place against girls and women, in all sorts of situations, not just conflicts or emergencies. I can assure the Committee that I will continue to work on that across the international scene, irrespective of whether those are countries that we have a bilateral aid programme with.

**Q215 Fiona O’Donnell:** Moving on, Secretary of State, to talk about the future of development co-operation between the UK and South Africa. Of course DFID will continue to have expenditure in South Africa. You have referred a number of times to technical assistance. How do you see DFID providing technical assistance to South Africa?

**Justine Greening:** Those are the discussions we have now kicked off with the South African Government. Obviously, this is a transition that will take place following the 2014–15 year, so we have some time. We have now set our intentions as to a changing basis of co-operation, and we are flexible, as it were, in terms of what we think that agenda on technical assistance could look like. It may well focus on continued work together on health, for example, or education or, indeed, violence against women. You will know that we are already also planning work, for example with the South African Revenue Service, to help other neighbouring countries within Southern Africa improve their revenue collection basis. We can have a broad relationship that continues with the South African Government. In terms of what we will do, we will very much aim to match their needs with what skills we feel we can offer, and that is a discussion that we will go through over the coming months.

**Q216 Fiona O’Donnell:** We will continue to have a DFID office in South Africa. I wonder if you could
tell us a bit about your thinking around keeping an office there and if it is something you think might be appropriate in other middle-income countries. The Committee has been to Brazil. Clearly, we also continue a similarly transitioned development relationship with Brazil. It is something for us to consider as we see our development relationship with countries transition over time. Do I envisage us having a host of offices in middle-income countries where we do not have bilateral aid programmes? No. Where there is a pragmatic taxpayer value-for-money approach that we can take, which makes sense not just from a DFID perspective but can bolt neatly together with Foreign Office objectives, it can be a sensible approach. We take a pragmatic decision on where we are basing our staff.

Q218 Richard Burden: You have made decisions in respect of South Africa and India that throw into focus the whole question of how we should have a future development relationship with middle-income countries. Do you see your decisions in respect of those two countries reflecting the way, in principle, we have that development relationship? In other words, essentially they should finance their own development.

Q219 Richard Burden: If you compared, say, India with Pakistan, in India the programme is finishing; in Pakistan, it has become the largest programme. What is it about Pakistan that it not only needs to continue but needs to continue at that level? What I am getting at here is to try to see if DFID’s approach to middle-income countries is essentially a horses for courses one—there is no overall view of what you should do; you just take it on a case-by-case basis, and there is something to be said for that—or whether it is a bit more systematic than that: “These are the things we look at. These are the indicators we use.” If we are going to have a strategy for helping middle-income countries address extreme poverty and inequality in their own areas, this is how we do it and there is consistency across the piece.

J ustine Greening: Going back to what I just said, within Pakistan, if you look at growth, it is far more challenging for that economy. There is not that track record of growth that you have seen in India. If you look at the current capacity of Pakistan to lift people out of extreme poverty, it is probably at a lower level than you would see in India, for example. I have been very clear with this budget: ultimately we want to use it to tackle extreme poverty. Alongside that, we should also not lose sight of the clear national interest that we need to have. Part of that is stability in making sure that we stop countries from sliding into more instability. We should make sure we invest where we believe there is a need to see development, because it does not just drive economic growth—ultimately it is good for us to be able to trade with countries—but it keeps countries stable and helps minimise and reduce the terrorism threat. One of the biggest programmes we have in Pakistan is on education. Why? Not only does that give people much better life prospects, particularly women and girls, but we also know that, from an instability perspective, it is a very sensible investment if you are going to help a country get that long-term stability that it does need to grow. When you look at where terrorism threats are coming from, we know that Pakistan has been one of those clear countries from which we have seen terrorism threats emanate. It is quite right that we work with the Pakistan Government to try to combat that collectively. It makes sense for us to help them tackle that at source, so that we have less of a risk to have to tackle it as it reaches our own shores.

J ustine Greening: As you know, we have co-located our office now at the British High Commission, and that has saved £350,000 a year, so it makes sense from a taxpayer perspective. We also run our Southern Africa regional programmes from that Pretoria office, which is a reflection of the fact that South Africa is a leading country on that continent. Its economy accounts for around 30% of the Sub-Saharan African economy and, therefore, it makes sense to us to locate a regional office in South Africa.

I have to say it also means, from a travelling perspective, because of the way in which South Africa acts as a hub for aviation networks, it is much more effective for us to be able to travel out from there to some of those other parts of the Southern Africa region that we work in, rather than being based somewhere else and having to hub out of a South African airport to be able to get around Africa. I am sure the Committee has all experienced elongated travel as a result of having to hub out of various African airports. It is logistically sensible but also, in terms of our ongoing relationship with South Africa, it makes a lot of sense to have our regional office run from Pretoria.

Q217 Fiona O’Donnell: Is that a model you might use for other middle-income countries?

J ustine Greening: The Committee has been to Brazil. Clearly, we also continue a similarly transitioned development relationship with Brazil. It is something for us to consider as we see our development relationship with countries transition over time. Do I envisage us having a host of offices in middle-income countries where we do not have bilateral aid programmes? No. Where there is a pragmatic taxpayer value-for-money approach that we can take, which makes sense not just from a DFID perspective but can bolt neatly together with Foreign Office objectives, it can be a sensible approach. We take a pragmatic decision on where we are basing our staff.

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Q220 Richard Burden: That is why you made the decision that you made in relation to Pakistan. If we look at the other side of it, around India, there are different challenges—still very large amounts of inequality, still very large numbers of people living in extreme poverty. What should the strategy be for somewhere like India, rather than what it should not be?

Justine Greening: The strategy for India, again, came out of lengthy discussions with them. We had a development programme of around £280 million a year. If you look at what they as a country are investing in their own health and education, it is around $40 billion to $50 billion. They were very clear with us that the thing they value most is our technical assistance on how to get the most out of the $40 billion to $50 billion that they are investing. I believe we should be responsive to countries that are transitioning and going through what is a long transition, in the same way the UK went through a very long transition, many centuries ago now, towards being a fully developed country. We have to evolve our relationship in the same way that they are evolving, and we have to be responsive to their needs.

It is quite right that we are starting to transition our relationship with the Indian Government on to one where we provide technical support. We move steadily from an aid-based relationship with them to trade-based. There is that period in between. We are navigating our way through that.

I guess what I would be very clear-cut about in this role is that DFID has a role to play in that transition. We should play that in relation to India by steadily moving away from aid on to a more technical assistance, returnable capital basis, where it is not pure grants. We move to so-called returnable capital, and that is part of the transition plan that gets us from having a relationship with a country that is dominated by aid to one that ultimately ends up where many of our relationships are with many of our trading partners, which is ultimately one that is dominated by trade.

Q221 Mr McCann: Secretary of State, your narrative is that your department is progressing these issues in a sensible, methodical way. Let me give you an alternative narrative. DFID made the decision to remove its bilateral programme from Burundi. It redacted all the reasons for it and would not allow the Select Committee to see it. With the move from India, despite the fact that the IDC report suggested we had to change our relationship, you withdrew from India at a time when there was a lot of speculation about space programmes and various other things happening there. With the decision about South Africa, which you have advised us this morning was mulled over for many months, as a Member of the Select Committee, I did not know that was going on. In terms of Pakistan, we are being told about the security interests and our national interests being important there. Would you concede that it might not be as methodical and sensible as you suggest, when people like me in the Select Committee do not really have a handle on how decisions in bilateral programmes are being made, and there is a need for more transparency in this area?

Justine Greening: Evidence sessions like this can obviously be helpful in giving me a chance to explain how we approach those decisions. The Bilateral Aid Review was a very robust approach, where we used a common approach for looking across the piece at what our bilateral aid programmes should be. We ended up reducing from 43 countries, when we came into Government in 2010, to originally 27 and then, when South Sudan broke from Sudan, to 28. People expect us, in a developing world, to continue to make sure we target the countries where we feel we can make the most difference.

As I have said, the way that we approach that is to look at prospects for growth, levels of extreme poverty—it is worth pointing out that the incidence of extreme poverty in Vietnam is higher than that in South Africa—and their trajectory, and, critically, the capacity of the country itself to be able to lift its own people out of extreme poverty. Indeed, finally, it is whether we have the capability and the comparative advantage to be able to have a sensible relationship with that country. I think we do have a robust process.

My sense is that, actually, the decisions we are taking come out of that systematic look—whether on the Multilateral Aid Review or the Bilateral Aid Review—broadly are sensible ones. If you look at them dispassionately, setting aside the process, they do seem to be ones that are sensible and reflect the progress that countries are making.

Q222 Chair: This leads us into the next session about forward planning. I think you can tell from the Committee’s questions, Secretary of State, that there was less concern that we were changing our relationship with South Africa than about the blip in the bilateral relationship that was attached to it, which was an understandable, and legitimate, cause of concern. Thank you very much for coming in and giving us an explanation and a talk through what was involved. We now move to the future of development finance, which is exercising the Committee. Just by way of introduction, you will be aware that the Committee visited Washington, specifically the World Bank and the Inter-American Development Bank, and also looked at Brazil, which was partly to do with finance and partly to do with knowledge transfer. We will be reporting on that in due course and reflecting on what we heard in that process. Perhaps just on the basis of your response to Mr McCann at the end of that last session, the position that the Government is setting is that we are targeting our bilateral aid on a diminishing number of countries, mostly poor countries but not exclusively. It is not just that. Is that sensible? It is a good thing the number of countries that are absolutely poor is diminishing.

I think I am right if I roughly say that, when people talk about “the bottom billion”, it was probably true, before the Bilateral Review and going back five years ago, to say that our bilateral programme reached nearly all of those people. From the review we have now, we only reach about 150 million of them. The other 850 million are in countries that we either do not have or will not have bilateral programmes in. The
question I am asking you is: is it sensible to concentrate so narrowly? How are other bilateral donors operating in these circumstances, where the world is changing? In a good way, I suppose you could argue, because countries’ income levels are rising, but there are still a billion people living in absolute poverty.

*Justine Greening:* I will bring in Stefan Dercon, who is our Chief Economist and has spent a career looking at development economics, but broadly, as I have said, it is right to target. You have to target. It would be nonsensical to continue to have a bilateral programme in a country that was successfully transitioning and developing and, in addition to that, had the wherewithal and the means to do that on its own. The British public would not expect us to be operating in those sorts of countries, and that is why it is right that we have a process that allows us to look systematically at how we work our bilateral programmes.

I would also say that it is not just about the money. You talk about a country like China or a country like Brazil. We have a good, in fact very good, development cooperation programme with China. It just does not focus on traditional financial aid anymore. It is really around us working with them, so that they can share their own learnings on development with other countries similarly aiming to develop—the so-called South-South co-operation. We absolutely continue these relationships.

What I am saying, though, is that it does not need to be based on money; it can be based on advice, influence and a different form of working relationship than purely cash. Where we have bilateral programmes, there are countries where we want to, and we feel we can, sensibly invest to help alleviate extreme poverty, and that represents our bilateral programme. Of course, we achieve some development objectives through the investment that we make through multilateral agencies as well.

Q223 Chair: I think we understand that. For example, the evidence we had on India demonstrated that, for India to lift 400 million people out of poverty, those who could afford to pay tax would be required to pay a marginal rate of over 100%. It is about money; it is about transfer as well as technical assistance. I think you have talked about £30 million a year for expertise. I think you have mentioned knowledge, expertise and where you have made sense. Spreading yourself too thinly in terms of technical assistance and that, therefore, concluding that we are in the wrong places at the wrong time. That actually misleads in terms of understanding what it means for us. The real thing is what the Secretary of State has alluded to: quite a lot of these poor people in these middle-income countries are living in countries that are on trajectories and prospects that are rather positive. They are on declining poverty trends while, in others, they may be much more stuck. Looking in a static way at where poor people are now and that, therefore, concluding that we are in the wrong places may not be the right way of looking at it. Looking forward is more important. What are these countries doing in terms of their economic development and growth? What trajectories are they on in terms of poverty reduction?

If you then start looking at it, quite a lot of poor people with poor prospects are not in the countries we focus on. Our targeting starts looking more interesting...
and correct, we would say, for the next few decades. At the moment, about 98% of extreme poor people live across about 73 countries. This is going to go down to about 50 countries. Some of the poor are in countries that are powering ahead, but if you then start looking at what countries we think, in the next 20 years, will have poor people, we are probably active in more than half of these countries, with a bilateral programme. We say, "There are other countries that potentially could be in but, here, we have something to offer and we have a comparative advantage from being there." There is a real rationale why we are in specific countries with high poverty and not in others. Thinking about how you engage with those other countries, the countries that are powering ahead, then clearly trying to do aid in the usual way is not the most effective way. Then we come to the way we think about transition programmes in India or, indeed, in South Africa. One needs to start looking at other ways of engaging with them, and money is not necessarily the binding constraint.

I am sympathetic to the analysis that you refer to, the marginal tax rate—the Martin Ravallion analysis. It is worth crossing off a list. His data are a little bit out of date, but quite a few people have been looking at it. India is an interesting one because, even in his analysis, it is somewhere near the margin. It is probably the next one where you could have said, "Well, maybe they can start self-financing poverty reduction now..." Indeed, if he had used the data that the national statistic office in India published in June, he probably would have come to a slightly different conclusion. India is on a trajectory of poverty reduction. There are still a lot of poor people, but they are making remarkably strong progress. That is not comparable to a Pakistan, a Nigeria or some other countries that may, on GDP per capita, look superficially similar now. There are some quite important differences. It is a general but simple point. Once these countries get richer, we have to engage in different ways with them. That is what we do. It is not simply whether we have a bilateral office, in the same way the Secretary of State has talked about, compared with how important it is in some of these other countries. We may well have offices in South Africa or other places to deal with these kinds of challenges. That seems to be absolutely right, also intellectually and conceptually. I think there is a real rationale and consistency in the way we are trying to approach these things now.

Q225 Hugh Bayley: You draw a distinction between India, on the one hand, and Nigeria and Pakistan on the other, and urge us not to look at GDP per capita as the only indicator of whether a country is on a trajectory out of poverty. What would be the most important alternative indicator? Would it be growth or unemployment? What should you look at?

Professor Dercon: I just tell you what we have, in practice in our analysis, been using. The last point you make is that, in the end, it is going to be whether a country is indeed having a growth process that is delivering poverty reduction. We look both at growth and the extent to which in countries, on current evidence, poverty is being reduced with growth. At the same time, we look at the self-financing ability. Do they have the ability to self-finance? These are the key factors. It is not growth alone. We look at economic development, always to the extent that it is delivering jobs and incomes for poor people as well.

Q226 Mr McCann: Secretary of State, if it is not always about the money, there is a question that follows on from that. Given that the number of low-income countries is reducing and given that those low-income countries have got a limited ability to absorb aid, the question then comes back to the 0.7%, as to whether or not you think that is a viable and appropriate figure for the future.

Justine Greening: I think it is. It has been a critical driver and mobiliser of ODA internationally. It sits alongside the Millennium Development Goals as what we need to be investing in. Of course, we are now having a debate internationally as to what the new development framework should be. As Stefan has just said and I have said, for countries that are now well into their transition as developing countries, we need to start thinking about whether we are going to transition our aid, so that it does not just necessarily mean it is about the money that goes in; it is about the advice, the support, the help on economic development and, indeed, putting our own private sector investment into those countries, so that that can be part of the development push. 0.7% is important for us. Yes, we may have fewer bilateral programmes; however, we also continue to invest in things like the Global Fund, which we know is a very effective multilateral body for tackling AIDS, TB and malaria. We know that, with sufficient resources going into that, we can reach a tipping point on some of those diseases that can systemically start to really turn the corner on them, in the way that we have seen the corner turned on polio across the world. Therefore, on so-called global public goods, there is still a clear agenda as well for us to make sure we can get value for taxpayer money in tackling extreme poverty. Over time, we have to evolve the portfolio that we invest to match bilateral programmes and multilateral programmes and then, within that, make sure we get the best value from the multilateral spend that we are making.

Q227 Mr McCann: I am very grateful for that. The other side of the coin, however, is that very few European Union states are going to hit 0.7%. Therefore, I would ask what your reaction would be, or what should the British Government's reaction be, to those states that are, in fact, travelling in the other direction, from 0.7%, rather than getting closer to it. Ultimately, given the furor that you know existed about 0.7% in the British public's mind, about whether we should do it or whether we should not, do you think there is a danger that we will stand out like a sore thumb, the only big nation in the world that is actually hitting 0.7% and making a strong commitment to it?

Justine Greening: I think we made and indeed many countries have made an international commitment to 0.7%. It is a longstanding one. We have hit it this year...
for the first time, and that is an important moment for us as a country, but also it is well recognised internationally. We want to see other countries live up to the commitments that they have made. Ultimately, I believe that spending this 0.7%, if done effectively, is absolutely in our national interest. Therefore, I do not see a compromise between what we are doing and what is in our national interest. It is in our interest to help countries stay stable, so that we can stay safe and have a better chance of reducing terrorism. It is absolutely in our interest as a country to be working in that next wave of emerging countries.

One of the things that I have been very clear about, within the Department and across Government, is the need for DFID to much more systematically work across Government on our broader Government agenda of helping to drive trade with that next wave of emerging economies. I think DFID can play a role that, alongside tackling extreme poverty, can help on this economic development agenda, and can really be a win-win, not only for the countries we are working in but also for our economy.

It may be that other countries take a slightly different view around what they see as the benefits of investing in development but, to my mind, it is also significantly about national interest. Interestingly, if you look at a country like the Netherlands, they have now put international trade into international development as a department, so they have matched the two up together. That does show that we are not alone in seeing the key national interest aspect of what we do, in terms of our bilateral programmes. It is right to have a joined-up approach.

Q 228 Fiona O’Donnell: Good morning, Mr Dercon. I do not think I have heard you or the Secretary of State yet talk about sustainability and where that sits in terms of economic growth in developing countries. You do often hear that you need to drive trade and growth in that next wave. Is it right to be thinking that they are being used in the development world, not just by us but by countries we are working with, to be working in that next wave of emerging countries?

Justine Greening: The original definition was essentially set in about 1972. We can all recognise that the world has changed and the development agenda has changed a huge amount since then. For a start, as we have been talking about, many countries are now steadily developing, so they are at a different point in their development, and economic development is becoming a more important aspect of their transition. Also, alongside that, we are seeing other flows beyond ODA, which are of course official government flows, becoming more important—for example, from the private sector in particular. We are also, though, finally seeing governments, whether in developing countries or indeed ours in the UK, looking at more innovative mechanisms, for example guarantees, loans and equity. I think all of that is prompting the beginning of a discussion at the OECD about whether it is time now to modernise this definition, try to bring it up to date and, in doing so, absolutely make sure that we are keeping the integrity of what ODA is.

Q 229 Hugh Bayley: Where do you stand, Secretary of State, on the arguments at the moment about whether the OECD/ODAC definition of ODA should be broadened?

Justine Greening: The core purpose has been seen as poverty alleviation. Does that remain the core essence of ODA? Hitherto, the core purpose has been seen as poverty alleviation. Does that remain the core purpose or does that become one of several core purposes? For example, the United Kingdom wants to see, which can really start to lift people out of extreme poverty, that and looks at access to capital, for example, and looks at the SME investment that can take place. That creates that much broader-based development that we want to see, which can really start to lift people out of extreme poverty.

Q 230 Hugh Bayley: I think you used the phrase “the essence of ODA”. Hitherto, the core purpose has been seen as poverty alleviation. Does that remain the core purpose or does that become one of several core purposes of aid?

Justine Greening: If you go back to the origins, it is around alleviating poverty through economic development. It is a slightly broader concept, if you like, than pure poverty alleviation. It is important to keep that basic concept, but underpin this current definition there. What we are saying is that the world has gradually changed. Some of the instruments that are being used in the development world, not just by us but by countries we are working with, are
changing. There is a general question about how to make sure we account properly for that in a way that means you can start to have that transparency across the piece and comparability.

**Q 231 Hugh Bayley:** Can I ask, perhaps you in relation to two and your economist in relation to one, about the suggestions for change that I have heard mooted? It has been suggested by some people that the ODA definition should be broadened to include some other global public good, such as adaptation to climate change. Is there not a danger that the “poverty alleviation through economic growth” focus could become diluted, so that there would be substantially less money available for poverty alleviation and growth in the poorest countries?

Secondly, it is suggested that the definition of military or perhaps security assistance could be broadened, so that ODA could be used more to create the security that is necessary for development. Where, might I ask, do you stand on those two? Could either you or your economist answer the point that some people are saying that some government loans to developing countries are now on terms that are frankly not concessional at all? How can one remove those loans from the ODA count, so that you only deal with loans that are concessional in character?

**Justine Greening:** I will obviously let Stefan also respond to this. You are right to flag up that we should make sure that this intrinsic original concept of what ODA was all about, which was poverty alleviation and economic development, remains. I would not want to see it watered down either. We need to make sure it is effective in today’s world, but I agree that it would not be sensible to start broadening it out as a concept so much that you end up losing sight of what you were ultimately trying to achieve. For example, there may be some people who would say we should include some kind of private sector investment. All of that starts to extend. You can look at cuts of data that might include that but, in terms of the basic classification of what governments are doing in relation to development, essentially you have to keep that original integrity to it, as you have said. That is the first bit.

On military, again similarly, we have to be very careful that we do not see an inappropriate re-badging of what is essentially military expenditure into development. At the same time, clearly where there is peacekeeping that is done by military units, a proportion of that, at the moment, can be classed as ODA. The proportion that is there at 6% falls out of some work that was done to analyse, in practice, what element of peacekeeping ought to be classed as ODA. You might want to refresh the process to understand what peacekeeping today looks like and, therefore, whether that percentage looks the same now as it did back in the 1970s but, fundamentally, I do not think you should extend it beyond that.

In relation to your final point on concessional loans, this is why, at some point, we clearly need to have a discussion around modernisation. That is a really important discussion. Again, the UK’s approach to this issue has been that we think loans do need to be concessional in character. There is a debate going on around how you define “concessional in character”, because that was never tightly defined within the OECD. Therefore, that is why at some point you need to have a proper discussion about this internationally and try to resolve some of these issues that have cropped up over recent years. Another issue that the UK would want clarity on, for example, would be around guarantees. We are not, per se, spending money; on the other hand, it can often unlock private sector investment that can have a development benefit. Getting some clarity around how that should be accounted for would be helpful to many countries.

**Chair:** I will bring in Fiona Bruce, because I think she has questions related to that.

**Q 232 Fiona Bruce:** I have two questions. One of them has been framed by Jeremy Lefroy, who we regret cannot be here today. He very much wanted us to read this question. It touches on issues that you have mentioned already. What use do you have of the current definition of ODA? Will you recommend any changes to the OECD? For instance, do you believe that it makes sense to include net investments or net disinvestments by CDC within ODA, when these are unpredictable and depend on commercial conditions, not government reporting periods? Also, what do you think of the fact that some countries are deliberately boosting their ODA by providing concessional loans, which are lately financed through the issuing of bonds, rather than coming from the country’s state budget? Is that sensible way forward for the UK, given fiscal conditions that are likely to remain tight for some time?

**Justine Greening:** The second point was what I was answering on the back of Hugh’s question. In relation to the first point, there is an ODA definition and, broadly, in terms of how it is approached and how we define it, it works. However, there is a need to make sure that it keeps up with the world today. Alongside that, yes, there are some challenges. For example, if we make an investment through CDC, it is classed as ODA, because cash is going out the door. Of course, if it is a very successful investment that has created a huge development impact and that investment has driven a big return, once we crystallise it, it creates negative ODA, because we get money back in through the door. In a sense, it looks like your disinvestment decision, on the back of some very successful investment, is almost a negative outcome, when in fact it is not.

My sense is that those are quite important discussions, which we need to have, about how we can make sure that we have an ODA definition that does not disincentivise good investment decisions. Ultimately, it is certainly clear in my mind that this underlying rationale as to how we define ODA and broadly what it is all about is quite clear-cut, which is investment by governments in relation to tackling extreme poverty, and in relation to this economic development agenda.

**Q 233 Fiona Bruce:** Could I ask a further question? If we accept your point about wanting to stimulate trade and the private sector, my question relates to SMEs. You mentioned SMEs. When we travel, there
is the constant refrain that we hear that SM Es— not micro but businesses that potentially will contribute to the tax base of their countries— cannot develop. They find it difficult to raise finance. At the same time, we hear that administration of grant support to them is also extremely difficult, because of the numbers. I wondered what work DFID is doing to look at how, practically, support can be given to SM Es, which, at the end of the day, are the majority of businesses in any country— ours and developing countries.

Professor Dercon: We have a wide range of routes to support SMEs. One of them is through CDC. It is worth pointing out that, of the 1,200-plus investments CDC has, around 460 are in SMEs. Alongside that, we have the Global SME Finance Initiative that we have set up with other donors to tackle this access-to-finance issue that many SMEs face. We expect, by 2016, that will have reached over a quarter of a million SMEs. In-country, for example in Tanzania, we are looking at whether we can do a piece of work to improve how the capital markets work there. I start from the premise that there is a huge entrepreneurial drive and spirit. What DFID needs to work on is how to unleash that. Capital is part of it; investing in infrastructure can be part of it too. Specific challenge funds that are there to provide direct investment can be part of it. Of course, CDC has a role to play as well.

Professor Dercon: I thought you were going to course, CDC has a role to play as well. There to provide direct investment can be part of it. Of that. Capital is part of it; investing in infrastructure can be part of it too. Specific challenge funds that are there to provide direct investment can be part of it. Of course, CDC has a role to play as well.

Chair: We have a number of questions exploring new instruments, starting with Fiona O’Donnell.

Q234 Fiona O’Donnell: It is not so much the controversy the Committee is trying to explore, but rather the Department’s thinking as to how it has developed. Secretary of State, you talked about the pace of change in developing countries and also the way that aid is being financed. What we are looking for is more detail in terms of the direction of travel of the Department and its preparedness. What specific new needs or opportunities have you identified for DFID, in terms of the fact that we are increasing the range of financial instruments that the Department has to use in developing countries?

Justine Greening: Over recent years, we have set up a number of different routes, if you like, to go well beyond traditional grant financing in terms of how you get investment into developing countries, including the strategy refresh that we have done at the CDC. I know you had Diane Noble in to give evidence earlier around how we can make sure their investments continue to target extreme poverty. We have set up the Private Infrastructure Development Group, which is a public-private partnership particularly focusing on investment in infrastructure. We have launched very recently our first Impact Investment Fund, which again is around leveraging in private sector investment.

We will continue to innovate around how we work with multilateral agencies. For example, we can partner up more broadly with multilateral agencies through loans or we can partner up on specific projects. We can look at whether we want to develop CDC’s ability and investment although, as I have said, we have reworked their strategy pretty recently. We could do direct lending ourselves, although I am sure you will have some questions around our capacity to do that and some of the challenges around DFID itself stepping into that sphere. There is a range of logical areas where we could extend our work, particularly in some transition countries, where we may feel a grant— putting money that we do not expect back into a country— may prove to be something we think we do not need to do. Finding a route to lend some cash that we do expect back may be more appropriate.

Chair: Presumably that is what you meant when you talked about returnable capital in India.

Justine Greening: Yes, absolutely. That is probably one of the first projects in bilateral countries that we have that works in that way. We will have to see how successful and effective that approach is, and that will inform the potential to do more of that over time. We also have to be pragmatic and careful. We already have quite a wide range of channels by which we can do a different form of investment that goes beyond our traditional grant aid. I do not think we are starting from a zero base. I think we actually have quite a sophisticated number of channels out there that we can use.

Q235 Fiona O’Donnell: Looking for a bit more detail, do you have any thoughts at this stage about for which countries and what kinds of projects bilateral concessional loans might be appropriate?
Justine Greening: I should say that, as of now, we do not have any plans to do any concessional loans directly to governments bilaterally. Our sense is that a more sensible route is to work with multilateral agencies, which often have the scale and reach, and can pull in not only other donor investment that is needed to get the level of investment required, but also the private sector.

Q 236 Fiona O'Donnell: Finally, do you think there is any possibility of the UK deciding that we should not engage in this and what we do best is to give grants to countries?

Justine Greening: We have to be prepared to look across the range of different modalities, as they would be called within the development world, as to how we can work with countries. Going right back to the beginning of this evidence session, as countries are transitioning, we have to go beyond doing pure grant aid. For some of the projects that we were working in, that is simply not appropriate. We have to match how we are doing our investment with the project, with the country and with what is actually most sensible in terms of pulling in other private sector and indeed public investment. We have to be flexible and we will work across the piece.

What we are seeing, though, is that, over recent years, that plethora of different channels we can use has grown, as we, other countries and, indeed, developing countries themselves have innovated. In the case of Africa in particular, we have started to really get a clear sense of what their infrastructure needs are, and, therefore, these very big projects that no donor country could finance on its own or would want to finance on its own are emerging, which actually require a much more international financing approach in order to make them happen.

Q 237 Mr McCann: Secretary of State, we have touched upon a couple of these points, so I will refine the question from the original text. In your written submission, you said that DFID officials have been working with HM Treasury officials on looking at the possibility of having a development bank. I just wondered if you could give us an update on what progress has been made and what the current status is of those discussions.

Justine Greening: It is something that we have looked at, at a relatively high level. I am interested in the inquiry that you are doing. The range of discussions you have had can be part of informing that process that we have kicked off within Government. What I would say, though, is that we should be clear that any move to set up a development bank is not going to happen overnight. It is a significant undertaking. It requires very careful thought around the skills that we would require, in order to be able to get that established, and running effectively and sensibly. Also, it requires very careful thought around what channels are already out there that we can use if we want to go down more of a lending-based approach, rather than grant-based, if we want to, over time, move down this road of expecting to get money back, possibly with some sort of return, compared with simply a more historical strategy of focusing on grants, which we pass over and are not intended to have any returnable aspect to them. I would describe any discussions around setting up a development bank as at a very early stage. We will take a very pragmatic decision around whether creating a brand new entity is really the most effective way for us to be able to achieve those objectives.

Q 238 Mr McCann: Is there any structure to those talks? Are they held on an ongoing basis? Are they in diaries, or does it become an agenda item whenever you are meeting about other subjects?

Justine Greening: They have been part and parcel of a broad review that I kicked off on coming into this role, looking ahead, just as this Committee is doing, at what the development landscape will be over the coming years and, therefore, what DFID's response to that needs to be, in terms of how we invest, where we invest, what we are investing in and the right channels to make sure that we are delivering best value for money. Looking at whether you continue to do grants versus whether you move to more loan-based and expect some of that investment to come back to you, so that you can reinvest it, is part and parcel of that review.

As I have flagged up, I see the discussions that we are having around any sort of development bank as much longer term, frankly, for the Department. It should not hold us up on the rest of what we are looking at. As I have said, it may well be that the most effective thing for us to do is to see whether we can achieve those outcomes through existing channels that are already there. That may be more effective. I think you also have to be very clear-cut around how we account for it in our own government national accounts too.

Q 239 Mr McCann: Our visit to Washington highlighted a lot of those challenges. I can understand your caution on that point. You have actually answered my follow-up question as well, in terms of working with others. The other only thing is you mentioned CDC earlier. You mentioned recent changes; do you feel that there is the potential for further expansion there, in terms of it being another tool in that particular box, rather than looking at, for example, a development bank alone?

Justine Greening: I know the World Bank itself is looking at its own approach, and Dr Jim Kim, who now heads up the World Bank, has done a very effective job of challenging that organisation to look at how it needs to modernise its approach, how it should be driving for results and where its priorities should be. I am about to get on a plane later this afternoon and go to the autumn World Bank meeting in Washington to make sure that I advocate for what we would like to see the World Bank doing.

This is the same question that they ask themselves, around what the right mix is of grants versus a more loan-based approach to development. I think we see that there is this potential to have more of a blend on returnable capital or a loan—whatever you want to call it—in relation to some of the infrastructure projects in particular that could be invested in over the coming years, which are often huge and probably need private-sector investment to match along with
any World Bank project. Stefan, do you want to add to this at all?

Professor Dercon: You have covered it comprehensively. It is clearly the case for either lending instruments or a development bank. The instrument side we should not look at in isolation, in terms of where the niche is, what the need is and where we actually fit in. Within the Department, as the Secretary of State said, we look at the whole series of options, which people have been looking at very carefully. It is clearly something that we have to keep live and keep on thinking about. These are very exciting times. There is a lot changing in these countries. The way we most effectively engage with them will keep on changing, and so there may well be a right moment. The choice at the moment to be a bit cautious and not jump into it seems to be the right one.

Q240 Hugh Bayley: Can you say a little bit more, Secretary of State or Professor Dercon, about how you have come to the conclusion that you need to be cautious? You appear to be saying “no”. For example, do you see any advantages from having a development bank over using loan finance—developing facilities to provide loan finance within the Department? Would it make a difference, for instance to the PSBR, if you had a development bank that could perhaps borrow money against contributions that a government is making? Would that make a difference?

Justine Greening: You have outlined the fact that a development bank—and indeed, if you look at France and Germany and the way in which they approach funding their development—does have a different mix of whether it goes to the government profit and loss or whether it ends up on the balance sheet. Our focus is clearly not only about course making sure that DFID plays its role in helping us meet Government requirements on deficit reduction and debt reduction over time, as we have said; critically, as Stefan has said, from a DFID perspective, it is also around the outcomes that we want to achieve and whether this is the right or most effective mechanism to achieve them. It is a matter of whether you actually need to set up something new to do that, or whether it is more effective to use existing mechanisms that are there—whether they are some of the things that DFID has set up, whether it is CDC, or whether it is the World Bank and other multilateral development institutions.

What I am saying is, from our perspective, we need to be absolutely conscious of how changing the way in which we do development impacts the national accounts, of course. Ultimately, from a DFID perspective, our look has been at effectiveness and whether it can give us more effectiveness. You could argue that one of the advantages of a development bank is it gives us an ability to raise capital into it from the markets. Those are the questions that, over time, we need to weigh up, but I have also been clear that you can leverage in private sector through other mechanisms already. Indeed, we do through the Private Infrastructure Development Group work that we are doing. It is not like we cannot do that now.

Q241 Hugh Bayley: I appreciate, as Professor Dercon told us earlier, that interest rates globally are currently at a very low level, but, if one were to set up a new instrument like a development bank, you would have to be thinking decades ahead and not of the short term. Thinking ahead to when global base rates might be significantly higher than they are now, would a UK development bank be able to borrow at lower cost or lend to developing countries at lower cost or on the basis of a longer period to maturity of a loan than an in-house DFID mechanism?

Justine Greening: In the absence of having a fully worked-through plan and proposal around a development bank and what investment portfolio approach it would take, it is not possible to say exactly.

Q242 Hugh Bayley: Are you doing some work with the Treasury? Are you working with the Treasury to develop those models or scenarios?

Justine Greening: At this stage, the discussions have been very high level and, as I have said, our instinct is to look to use existing mechanisms, rather than to set up something new, which, in any case, would take some time to establish and would require bringing in new skills as well in the practicalities of setting up some sort of development bank. For the time being, the weight of our focus has really been on how we can use existing mechanisms and how we can continue to drive this economic development agenda through pulling in private sector investment.

Q243 Hugh Bayley: Presumably you need those new skills—the ability to assess the performance of a loan, rather than the delivery of a grant-funded development project—even if you are providing loan finance within the Department, will you not?

Justine Greening: Skills within the Department, and within any department, will need to change over time to match a changing agenda. As we ramp up our work on economic development, we will need to pull in new skills from outside to match that agenda. I do not think it is particularly different in relation to a policy around establishing a development bank in the future from any other transition that we might have. One of the reasons why I have been keen to go through a similar process to the Select Committee, which is to look ahead to understand where DFID needs to be, is to understand what that then means for the skills we have in the Department and also what we need to potentially bring in or otherwise access externally.

Q244 Hugh Bayley: To ask one final question, you made the point earlier, Secretary of State, that the UK moved away from using loan finance in response in part to the debt crisis that was faced by many developing countries. If we go back to using loan finance, how will either your Department or, were it to be established, a development bank guard against the risks that the countries to whom we lend money would, once again, end up with unsustainable debt burdens?

Justine Greening: Two points on that. I do not think it was a case of moving away. What I was saying was this is clearly an area, in relation to financing of
development, that is growing over time, because of the nature of how development is changing, and particularly some of the infrastructure projects that are out there and the private sector investment that can go into them, which can often be matched with public sector. Could you just remind me what that second point was?

Hugh Bayley: If you are doing more loans, how do you guard against over-indebtedness by developing countries leading to a sustainability crisis?

Justine Greening: That is a very important point, and there are well grounded, recognised approaches by the World Bank to look at indebtedness levels and when those levels get to becoming unsustainable. You would want to factor that into any thinking around any loan approach. I have been clear already in this evidence session that we do not have any plans to do any bilateral loans to governments, at this stage. I do not think that question arises, but what I am saying is that there is a very clear process at places like the World Bank for establishing countries’ capability to take on additional debt. I think it is a very important question that you raise because, of course, we went through a program of getting rid of some historical debt, because we could see just how much it was weighing on countries in their ability to be able to invest themselves in development, from debt that they had built up in previous years.

Professor Dercon: If I quickly add to that, it is exactly right. We went away from that for very good reasons, at the time. Of course, it is again that the world is changing. A lot of these countries are in growth cycles that actually have never been seen in these countries. At the same time, to re-emphasise this process, when we were looking at it within the Department, of course that sustainability was a key element. Nobody would want to go back to doing it irresponsibly or whatever. Taking it as part of a cautious approach, we are at the same time saying, “Is this the right moment for us to be doing this?” This is definitely one other element of the mix that we would have considered.

Q245 Hugh Bayley: If one used or possibly adapted a World Bank tool, should we start loan finance, would that tool also, if you could, then be a part of loans to the government? One thinks a lot of BRICS investing a lot in developing countries, a good deal of it being loan finance, on terms that are not constrained by ODA requirements.

Professor Dercon: In a very simple way, the tools that the World Bank has are not just like, simply, a debt sustainability ratio or whatever you would calculate. When we looked at it, and people looked at it in a couple of countries—as a case study, we had a careful look at it—these days, the IMF and World Bank would take into account what Chinese loans are doing. There are some well publicised examples in the DRC and so on, where things were taken into account. That is obviously all part of the whole set-up. It is difficult; it is complex. It seems to me that something we have to do this extremely carefully.

Justine Greening: It is fair to say also that some countries are themselves going out to the capital markets, doing their own bond issues and raising loan finance, as many developed countries would do. It is worth bearing in mind that, again, it is not just through multilateral institutions that they are able to raise finance.

Q246 Chair: Obviously, Secretary of State, we are hoping that our report may actually help these deliberations, because we have collected evidence from a number of quarters. The interesting thing is that we absolutely accept that you could not set up a development bank overnight and you need to develop a range of instruments in the mean time, whether or not you go down that route. It is interesting to hear from specifically the Japanese and the Germans that they started out with a mix of instruments and then, ultimately, concluded that a development bank was the logical way to bring them all together. It is an interesting piece of evidence.

Also, when we were in Washington, both the World Bank and the Inter-American Development Bank were offering almost a partnership, in saying they would appreciate embedding DFID people within the institutions, enabling them to gain insight and understanding, and add value to the Bank as well as adding value to DFID. These are ideas that might be coming through. Obviously, we still have to deliberate on our report, but quite a lot of different options, mixes and models are being pursued.

Just a final point on Hugh Bayley’s question about sovereign debt: I completely accept that we are in a different era, where quite a lot of these emerging countries have the capacity to take on debt, which should not really become unsustainable, but might still regard the combination of a concessional loan with technical assistance to deliver some of their public programmes as a way forward. When you said you were not considering that, certainly in my mind, and I think in those of some other Members of the Committee, there was a feeling that might be the way you would want to develop a relationship, for example with India or with comparable countries of that kind.

Justine Greening: There is a difference in my mind between a general strategy of saying, “We are now going to do sovereign lending,” and a pragmatic approach to saying, on a case by case basis, there was a clear option that represented good value for money and was sensible, and we understood through due diligence and risk assessment that it was a proper approach to take, you could consider that. However, that is different from saying that, systematically, this is now going to become a significant part of what we are doing. It goes back to the point I made earlier, which is that there is a range of different mechanisms we can use in order to carry out investment. It is about finding the right one for the right project.

Q247 Chair: I am not going to ask you to view this as a specific point but as an illustration. If, for example, on a technical assistance programme in a country like Ethiopia, they identified a problem, for example of maternal malnutrition amongst mothers and babies, and wanted to roll out a public health programme across the whole country on the back of that technical assistance, is not that the sort of context where there might be just a basis for saying, “We have
given you the assistance to manage the programme, and we will also help you with finance in order to add to your own capacity to deliver it across a country of that size?"

**Justine Greening:** Interestingly, that is one of the potential benefits of doing the Impact Investment Fund that we launched last November, where you could have a public policy imperative that could pull in a private sector solution to it that would match up with our DFID Challenge Fund and generate a return, because it was fundamentally delivering a more effective lower-cost approach to the public sector.

**Q248 Chris White:** Secretary of State, you have highlighted, this morning and in recent speeches, the importance of economic growth in DFID’s work. I was wondering how you think DFID will liaise with the private sector to support this, in terms of growth and poverty reduction.

**Justine Greening:** There are a number of strands that we need to look at. One is in relation to the domestic situation within developing countries. We talked a little earlier with Fiona Bruce in relation to some of the work that we are doing on SMEs domestically. We also have a number of projects that look at how to reduce red tape, so TradeMark East Africa is a very good example of investment in infrastructure, but also streamlining processes, particularly customs processes, which can often mean that the cost of transiting goods across parts of Africa is significantly higher than it needs to be. Therefore, it becomes a real barrier to trade and economic development. We have also done a number of programmes around access to finance, and we will continue to look at more opportunities in-country. Of course, there is microfinance, which is perhaps one of the things that many development institutions have done over recent years that has got more publicity, but it sits alongside a portfolio approach.

Alongside that, I have been clear that we can do a lot to help unleash entrepreneurship in those countries. We can also play a role in helping to drive responsible UK investment that can make a positive difference to development as well. That is why I have been clear to start engaging with the CBI, with various sectors like the retail and garment industry sector, for example, and extractive industries with the infrastructure companies, to really start understanding more clearly how we can work more effectively together and also where that relationship should join. There are some things the private sector should do and there are other things that perhaps DFID should do, and there is clearly a point where we can work together. We need to be clear between ourselves and the private sector within the UK about how that relationship can work more formally.

I also think that DFID has a lot of knowledge on the ground about the countries we work in. That can be put to good use to help drive responsible investment faster. I am particularly interested in looking at countries like Tanzania, where I think there are some interesting opportunities around partnering up UK investment that matches with their development aspirations as well.

**Q249 Chris White:** You mentioned microfinance and entrepreneurship. Some of the most successful initiatives we have seen in Africa have been associated with those projects. Do you see the number of secondments from DFID to the private sector and vice versa rising? Also, do you have any intentions to measure the impact of DFID’s private sector investment?

**Justine Greening:** We can develop our knowledge base by working more effectively with the private sector. I do not think that just goes for some of the opportunities I have just talked about; I think that goes for our work with suppliers from the private sector that help to deliver some of our programmes. We have secondments there as well to deepen that relationship, so we get better value for money. On top of that, as I said earlier, over time our skills will need to change so that we have a bigger footprint within the economic development agenda in the future than we have had in the past. That will mean we need to have the right skills and the right people to be able to help us pursue that.

**Q250 Chris White:** Just the last couple of points: do you think you have the right financial instruments to work effectively with the private sector? Do you think your instruments match and balance? Do you think there is a role for DFID to provide non-concessional loans to the private sector?

**Justine Greening:** We have a range of instruments. We are innovating new ones: this Impact Fund that we launched last November was the first impact investment fund in relation to development. I would be very keen to see London and the City emerge as a leading global centre for impact investment within developing countries. That would be good for us and it would be good for the developing countries that we could help drive capital towards.

**Q251 Chris White:** Do you see us, DFID, promoting that particular initiative regarding London and the City? Do you think there is work to be done?

**Justine Greening:** There is work to be done and, indeed, it is the reason why I gave my opening speech on economic development at the London Stock Exchange. It is why, since, we have started to engage more systematically with different parts of UK industry to understand how we can work effectively together on responsible investment going into developing countries. I think it is a very exciting agenda and that, over time, we will continue to think creatively and innovatively about some of the ways we can partner in with UK industry to jointly help drive development.

If you look at some of the projects that we have already kicked off around global value chains, where, for example, we will work with John Lewis, I think in South Africa, that is a very good example of a programme that is providing job creation and skills, but also makes good business sense for them and is sustainable. Ultimately, all companies need to have sustainable value chains. It is about finding these common-ground areas, where we can unlock a win for development through working with the private sector and actually, for them, doing the right thing is good
business sense too. We can do a lot more around understanding the breadth of that agenda and also then where it is sensible and responsible for DFID to be part of it.

Q 252 Fabian Hamilton: Secretary of State, given the changes to development challenges and development finances, are you confident that DFID still has the right balance between bilateral and multilateral aid?

Justine Greening: Over time, you will see that balance shift. We do not, per se, approach our resourcing within the Department by saying, “How much do we want for bilateral? How much do we want for multilateral?” We will have a general approach on replenishments. For example, the World Bank is coming up to replenish through a new round of IDA. The Global Fund will finally go through its replenishment this November. We of course have to respond to that over time.

Alongside that, though, we also have what I might call a bottom-up approach to what the opportunities are in our bilateral programmes. We, of course, do the Multilateral Aid Review and the Bilateral Aid Review to get a sense of consistency across the piece, around where we think best value for money is to make sure that we are not just spending in the right places but driving effective spend that is value for money.

Q 253 Fabian Hamilton: You do not think that there is a particularly desirable balance between multilateral and bilateral spending. What do you think would be the most likely balance, in the next five to ten years, between the two, or can you not predict that?

Justine Greening: It is hard to predict it, because a lot of it falls out of decisions that we may take around how we want to, for example, invest in tackling malaria. We know that malaria has a much bigger element of our economic development strategy than people perhaps realise. In a place like Ghana, treating your family for malaria is about 30% of your household income a year. The question for us is: what is the best way for us to drive value in investing in tackling malaria?

The Global Fund has been a very successful multilateral organisation that has pulled in both private sector and public sector investment to tackle malaria. We will predominantly use that. Will it mean that we do not do any malaria bilateral work? Probably not, but we will do it where we think there is a complementary approach that can really work hand in hand with what is already happening through the Global Fund. It comes down to understanding value for money, the different channels we can use and then getting the right mix on an overall strategy, for example in tackling malaria. That is not a bad example of where you probably need a mix between what we do multilaterally and then bilaterally but, over time, I would expect that you would probably increasingly do more through the Global Fund, for example, than you would do bilaterally, as the Global Fund develops and becomes even more successful than it has been in the past.

Q 254 Fabian Hamilton: Does DFID have the skills and the tools to be able to assess the overall or relative strengths between bilateral and multilateral spending, or is that something you need to buy in?

Justine Greening: We do have the skills. The Multilateral Aid Review, for example, is something that the National Audit Office has pointed to as a much more robust approach for consistently looking, from a comparable perspective, across a range of different institutions in saying how they are performing and who is giving value for money.

The biggest challenge to these processes is around the evidence base and making sure you have good data to go into that process. We are very capable of running sensible processes around multilateral aid and bilateral aid. It is about having good data. As an aside, one of the things we pushed at the High-level Panel that the Prime Minister co-chaired was this so-called data revolution. When you look at progress on the Millennium Development Goals, one of the challenges, looking back on it, was not having good baseline data. There is a data challenge on how we can take decisions.

That is not to say that we do not have a very good evidence base of what works and where you get value for money. A lot of the work that Stefan’s team does is around helping us make sure we get the most out of every pound. We are flagging up that we think you need to push even further on data, but the Department is well placed to understand what works, how to target and then how to do that process on an ongoing basis.

Q 255 Fabian Hamilton: That is very reassuring. One final question, Chair, if I may: do you think that global public goods, for example climate finance, are better managed through multilateral spending and, if so, what is the role for bilateral donors?

Justine Greening: As you will know, the push around financing for climate change and combating it, both in terms of adaption and mitigation, has been international. In 2009, there was an international commitment to raise $100 billion in order to do that, and the UK will play its role. You then have a similar mixed market between some projects in that regard that need to be taken at a more international level, simply because of their size, and then other projects that can happen at a more bilateral level and that can be done by individual countries or, perhaps, two or three countries working together with a third nation. In many respects, it is driven by the nature of the work that needs to take place.

Professor Dercon: To add to that, almost by their nature, if they are global public goods, they involve collective action problems. We need to engage with these. It is really at that level that we have to start, and the finance is then something that follows. That is why it is very important for us to engage in all these processes multilaterally and with our partners.

Fabian Hamilton: The very nature of global public goods is that they are multilateral by definition.

Professor Dercon: Exactly; they are collective action problems that we need to overcome.

Q 256 Chair: Some of our witnesses did say that, although the Bilateral Aid Review and the Multilateral
Aid Review were generally regarded as very good things, there was not a crossover. In other words, there was no evaluation of bilateral versus multilateral, and it may be something that the Department should consider doing, because they were put in two separate boxes rather than asking, “Would this be done better bilaterally or multilaterally?”

**Justine Greening:** That is precisely what we looked at over recent months, as part of our broader review: how to get some confidence about whether that final pound invested in malaria needs to go via Global Fund or via a bilateral programme, and in which country. That is exactly what we have been looking at to try to get much more clarity around how you drive value for money and the comparative effectiveness of these different channels.

**Q257 Fiona Bruce:** I wonder how, if you do, you operate a different method of implementing the monitoring of multilaterals where there is no DFID presence in a country. Do you take a different approach to monitoring them there?

**Justine Greening:** We are able to keep track of what is going on in interestingly over recent years, for a much tougher and stronger results framework for the World Bank, so that the processes in place to track are more effective. We have our embassies; we work with other donors that are there. We are absolutely able to understand how effective programmes are. Clearly, where we have a bilateral programme there and we are there every day, that enhances our ability to understand how projects are being delivered by the World Bank.

We are very clear around the results agenda that the World Bank is pursuing and Dr Jim Kim is really pushing now, appropriately. That is part of making sure we can understand, on a day-to-day basis as well as more strategically in terms of priorities, how effectively the World Bank is performing. When we went through the Multilateral Aid Review, the IDA funding came out of that very well, so that was seen as an effective investment in terms of development outcomes and value for money.

**Q258 Fiona Bruce:** Do you think you could do it more effectively if you did have regional offices and programmes in those countries?

**Justine Greening:** By definition, if you were there every day, you would have more chance to get more insight on a day-to-day basis. You would have to set against that the cost of doing that and the need, ultimately, to have good World Bank processes in place that are transparent and a good organisation that delivers value for money as a matter of routine, without you necessarily having to look over their shoulder. That is why we have pushed for an improved results framework from the World Bank, and it is why we are very keen to advocate for the right priorities at the World Bank for the next IDA replenishment.

I should caveat all of that by emphasising again that, when the World Bank went through the Multilateral Aid Review and the IDA funding was looked at, it actually got a very good rating from our Multilateral Aid Review process. I do not think we go into this monitoring and evaluation question thinking that there is a major issue; it is something we want to see continue to be improved, but we are already well placed to understand the effectiveness and the value for money of the World Bank work.

**Professor Dercon:** Could I maybe add to that? It is just to re-emphasise that, if we want to monitor multilaterals, it is not by being in every country where they are doing something, but it is getting very strong representations within these organisations. That is what we have clearly invested in. Results frameworks then become the way you properly manage your funds within it and push for indicators that actually mean something. That is the strategy we use.

**Q259 Fiona Bruce:** That is very interesting, because one of the reasons we are asking about this is that, on our visit to Brazil in particular, it was suggested that maybe one of the ways of facilitating knowledge transfer is to have not necessarily a regional centre but teams sent out by DFID to work with multilaterals—embedded in them—or even interns sent out for a period of time. I wondered if you could tell us to what extent DFID might be doing this or might consider it.

**Justine Greening:** I can clarify this with the Committee, but I think we do have a secondee over at the World Bank and, of course, we have a whole team based pretty much in the World Bank. They are not seconded to it; they are there to work for DFID, but they are there on a day-to-day basis to make sure that they are advocating on behalf of the UK. In order to do that, they clearly work with the Foreign Office very seamlessly as well.

**Q260 Fiona Bruce:** The kinds of things we were looking at were very grassroots. They were things like how to transfer knowledge about forest management, so that indigenous peoples living in the Amazon—and I understand they are about 25 million—actually have a sustainable livelihood. It is about whether there are ways that we could ensure that experts could go out from the UK to work with teams, for a period of time—it might be six months or it might be a year—to facilitate knowledge transfer, and not just within a country but South-South.

**Justine Greening:** You are right that making sure expertise can be shared is very important, and that has really been the focus of the development work that we are doing with Brazil. They have clearly gone through their own transition, in terms of poverty eradication. Part of it has really been around agriculture and livelihood; part of it has been around social safety nets, for example. Therefore, we work with them to help share that knowledge.

Indeed, India itself is playing quite an important role in sharing its knowledge of poverty eradication with other countries where that can be beneficial. It is something that we very much support. What it shows is that this investment is seeing clear results on the ground. There are countries that have now dramatically developed and, in doing so, with that growth lifted millions of people out of extreme poverty. Of course, China would be another example. It is really sensible to work with them to get those learnings from those countries properly disseminated.
into other places where they have consistent challenges and they are going through the same process.

Q261 Fiona Bruce: What is needed now is really specific expert and often technical knowledge, rather than perhaps general representation in a country.

Justine Greening: That might be technical knowledge, for example that a country like Brazil has. Therefore, what we can do and the relationship we can have with them that works is working with them to help get their knowledge out, as well as partnering up with our development knowledge.

Q262 Hugh Bayley: Does the Department have any programmes to increase or enhance the South-South co-operation between countries in Latin America and other developing countries, Sub-Saharan Africa and elsewhere?

Justine Greening: We do. We have developed a very good working relationship with both Brazil and China, as two good examples of that. I myself co-chair the Global Partnership for Effective Development Co-operation. It is very much a piece of work that sits alongside, first of all, the Busan Agreement, which looked at how you can co-ordinate development more effectively across different donors and countries, but also alongside this debate on the post-2015 framework. If that is the “what” in terms of what the new framework should be and where we focus attention, the work that is happening on the Global Partnership is about how we can work together to help deliver that.

We will be having a ministerial-level conference in Mexico next year that will pull together that work, which will hopefully be another step forward in terms of global co-operation on development. It will, as part of it, have a specific element that will focus on this South-South co-operation. That is very welcomed across the development community.

Q263 Hugh Bayley: Are there any lessons you are able to draw so far on what kind of South-South co-operation is effective, how you effectively transfer ideas and technology from South-South countries, and what you can achieve, in terms of value for money, through South-South co-operation that you cannot through North-South co-operation?

Justine Greening: Part of the reason for setting up this Global Partnership work is to more systematically look at how we can knowledge-share. There has been a general sense that it is a good thing to do, but that it often happens on quite an ad hoc basis, so we should more systematically look at how we can knowledge-share and particularly how we can get South-South co-operation.

We are also going through a process of understanding what works, as we have done in many other aspects of development, which are much older in a sense. For some of the work we do on health and education, we have a good sense of what works. On this South-South co-operation, because many of these countries are comparatively newly transitioned, as it were, and newly involved in a broader development push, we are understanding how they want to be involved and also what works for the countries that they can work with.

For example, you may have a state in India that has had a particularly successful programme around safety nets or around the right to information that has helped people access public services more effectively, which can then partner up with another country. It needs to go beyond the national level to potentially also include the sub-national level, where the size of a state in India can be as big as some of the countries that they might want to partner up with. The challenge has been how to work through that. Ultimately, it is for the South-South countries that we are talking about to work through how they think that relationship can work in the future. The Global Partnership is really about making sure we can help that discussion and debate take place.

Chair: Are you able to provide us with a bit of a note about how the Global Partnership operates? That would be helpful.

Justine Greening: Yes, I would be delighted to. In Washington over the next few days, we have our next steering group meeting on that, and I would be happy to give you an update on that work. The group is co-chaired by me, the Planning and Regeneration Minister of Indonesia and also the Finance Minister of Nigeria, who as we know plays a big role internationally on the development agenda—Finance Minister Ngozi. It is also now joined by representatives from the Mexican Government, because they are hosting the key meeting that we will be at in order to push this agenda and take it to the next step.

Q264 Hugh Bayley: Finally, in relation to Brazil particularly, where we have a small office to do this kind of work, what do you see as the achievements of that small office over the last three years or so?

Justine Greening: It has been extremely good for broadening out our relationship with the Brazilian Government and for transitioning our relationship on development with Brazil, which clearly came from an original basis of there being a four-country programme and has evolved over time to one that sees us now working with them to work with other countries on their development agenda. It is a good example of where we can have a very strong development relationship with countries that is not about a huge bilateral aid programme, and is much more around us working together on a common agenda.

That is a sensible thing for us to do, because it sits alongside our broader relationship that the Foreign Office has and leads, on a day-to-day basis, with Brazil. It is all part of developing a really strong relationship with what is a very important country and clearly a growing economic player on the world economy scene, and one that we not only want to develop our diplomatic and development relationship with, but of course develop our trading relationship with too.

Hugh Bayley: Thank you for that. Good luck on the IDA replenishment and other matters in Washington.
Chair: Thank you very much, Secretary of State. I hope, first of all, you found that a useful exchange. I think we have. We will be able to provide you with a report, which we hope will be before Christmas, on this particular aspect of future development co-operation that draws together some of the ideas that we have had. I do not see it as us necessarily saying, “We think you should do x, y and z.” What we will be teasing out is the options that we think you are facing, with perhaps our own Committee views as to which we think are the most interesting. We certainly have a lot of very valuable information. What has been interesting too is the enthusiasm with which other bilateral partners have sought to engage with us as a Committee, as I am sure they have with you as a Department. Notably, the French, the Germans and Japanese all have a different agenda, including the possibility of a joint visit by French Development Committee Members and us to West Africa next year. It is a possibility, but it would be quite an interesting development.

Justine Greening: That sounds like a potentially very interesting trip that raises development co-operation beyond Government Departments.

Chair: Indeed. Thank you very much. We look forward to seeing you again.
Written evidence submitted by the Department for International Development

Introduction

1. The Department knows from its recent horizon scanning and analysis—and analysis produced by others, including the IDC—that the development landscape has changed rapidly, and will continue to change rapidly, affecting the nature, context and geography of poverty and the future prospects of the poor. In recent years, many developing countries have experienced fast growth, and in most parts of the world, poverty has been decreasing, albeit at vastly different rates across countries and regions. DFID also knows that population trends, urbanisation, natural resource riches and technology will offer a unique opportunity to accelerate and lock in these gains. Despite this opportunity, the majority of the poor will live in transition countries (with average incomes of less than £1,000 per person per annum), with an ever increasing number concentrated in fragile states, and in countries affected by the impact of climate change and resource scarcity.

2. The analysis also highlights that the financing support to, and the needs of, developing countries is changing, due to economic growth and the rise of alternative funding sources, including capital markets and emerging powers. Private sector investors as well as large scale private philanthropy have become increasingly important; so too have remittances. The World Bank estimates remittance flows to developing countries rose by 6.5% in 2012 to total US$406 billion and are projected to grow to US$685 billion by 2015.

3. These changing financing flows and the changing prospects for poverty exit by the poor in some countries, determined by the extent and pattern of economic growth, challenge how development is supported. This is especially true in the poorest countries (low-income countries), the most fragile countries (where conflict and violence is the biggest barrier to reducing poverty) and those countries which are transitioning out of extreme poverty.

4. The combination of the changing context of poverty, alternative financing sources and the rising UK development budget have led the Secretary of State to initiate internal work on the kind of organisation DFID wants and needs to be to support the new post-MDG framework and tackle the development challenges in 2015 and beyond.

Question 1: Whether the 0.7% ODA target will be appropriate in the long term

5. The UN’s development financing target, which calls on economically advanced countries to allocate 0.7% of their GNI to Official Development Assistance (ODA), is both long-standing (having been first enshrined in a UN resolution in 1970) and widely recognised. In 2005, for example, EU Heads of States specifically committed to increase collective EU ODA to 0.7% of GNI by 2015. Since 2002, the combination of the Millennium Development Goals and the 0.7 target have resulted in renewed political support for official development finance and an unprecedented increase in global ODA levels. The 0.7 target also provides a firm benchmark against which to measure donor effort and encourage international burden sharing. The Government is therefore committed to spending 0.7% of GNI as ODA from 2013 onwards.

6. The Government believes that the 0.7% target will continue to have relevance in the longer term, both as an established benchmark for international burden sharing, and as a way of encouraging an on-going flow of ODA. With its tightly governed definition, concessional nature and focus on poverty reduction, ODA will continue to play a critical role in global development. It is important to complement this quantitative target with measures of quality and impact of development cooperation.

Question 2: Whether DFID has the right mix of financial instruments and whether it should introduce new ones, including concessional loans, the balance between loans and traditional grant aid; and the role of the UK as a provider of climate finance

Question 3: Specifically whether the UK should establish a new, independent development finance institution to offer concessional loans

7. As countries steadily transition and become emerging economies the Department’s increased emphasis on economic development means there are a number of possible new financial instruments which could be introduced alongside traditional grant financing and the operations of CDC. For example, lending to partner governments and enhancing private sector capital flows into developing countries.

8. Lending could occur either on DFID’s balance sheet or through a separate legal entity, which could be a small-sized entity or a larger independent development finance institution. All of these options could lend to multilaterals such as the World Bank who then on-lend or to countries either by co-financing multilateral loans or as stand-alone lending.
9. The criteria being used to assess these options, including whether the UK should set up a separate legal entity for lending, are:

(i) Development effectiveness: In terms of addressing barriers to poverty reduction and allowing a new partnership with these countries.

(ii) Administrative requirements: The time needed to introduce an instrument, the skills required and cost of administration.

(iii) Potential demand: This would need to be determined by a variety of factors including: if a country has a development financing gap, its debt levels as informed by the IMF’s Debt Sustainability Analysis, the nature of UK engagement, and if DFID has a comparative advantage.

(iv) ODA and IDA frameworks: The UK’s development expenditure must adhere to the Official Development Assistance (ODA) guidelines and the UK’s International Development Act.

(v) The implications for Government expenditure and borrowing: the extent to which an instrument might enable a higher level of ODA for a given level of government expenditure and the impact on the Government’s net public sector borrowing requirement.

10. For an independent development finance institution the administrative requirements and the implications for government expenditure and borrowing are particularly relevant. Officials are currently exploring the administrative costs of similar institutions as well as discussing with HM Treasury the impact on the PSBR.

11. For climate change related finance, DFID is increasingly financing intermediaries to provide loans, guarantees (an example being the Asia Solar Loan guarantee) and equity (eg CP3 Climate £110 million equity project) alongside grants and reimbursable grants (challenge funds). It has also invested in micro-insurance schemes eg for smallholder farmers and is looking at wider insurance schemes eg Africa Risk Capacity. These instruments give us more flexibility to address specific market failures eg equity is particularly useful for high risk businesses such as early stage ones. The Green Africa Power project uses debt with equity features to address the absence of long-term patient capital for power plant projects in Africa and a contingent credit feature to tackle power plant construction risk concerns. Along with bidding mechanisms such as advance market commitments or reverse auctions these instruments can reduce the risk of over-subsidy, which is important not just for taxpayer value for money but also to avoid distorting the market and crowding out competition or local finance players. Guarantees can address investors’ concerns around policy risk or perceived risks effectively or underwrite for example carbon market type instruments.

12. The OECD DAC definitions and rules set some constraints on the use of loans, equity and guarantees in a bilateral project. This is something a number of countries, including the UK, are raising in ODA reform discussions at the Development Assistance Committee and in the EU.

Question 4: Whether DFID has the right balance between bilateral and multilateral aid

13. Decisions on bilateral funding were based on the Bilateral Aid Review (BAR), which identified good value for money results offers from DFID country offices, (building bilateral allocations from the bottom up). Similarly, the decisions on core multilateral aid from 2011 up until now were based on the Multilateral Aid Review 2011 (MAR), which assessed value for money for UK aid across the multilateral organisations. Based on these assessments, Ministers increased funding to the best organisations, and stopped funding to the worst—except where wider UK interests or critical development roles implied a need for continuing UK engagement to urge reform. The MAR was commended by the NAO in its recent review, noting that “The Department’s multilateral aid review provided a much improved basis for deciding how to allocate funding and for promoting multilateral effectiveness.”

14. In making decisions about our multilateral funding, wherever multilateral organisations are delivering outputs that could be delivered through DFID’s own bilateral programme we want to consider which channel would deliver the best value for money. It is important to note that there is not often direct competition between multilateral organisations and the DFID bilateral programme. Instead, multilateral organisations often perform roles which complement those of bilateral programmes—delivering public goods such as international agreements, reaching the poorest in conflict zones where bilateral donors are not welcome, shaping markets to reduce the cost of vaccines for poor countries, managing large, complex regional infrastructure projects, for example—and this makes it difficult to make direct comparisons of value for money across the two channels.

15. Comparing DFID with other bilateral donors, the data suggests that DFID gives a slightly higher share of non-EU aid through core multilateral funding than most donors, but that it is well within the normal range of 20% to 30%.
Question 5: What lessons can be learnt from other national donors

16. Some donors use their bilateral development agencies to directly provide a greater range of development finance instruments, from grants in low income countries, to loans at close to market rates in middle income countries. Loans to middle income countries often combine public budget funds with funds raised at capital markets. This allows those donors to provide financing that is specifically targeted to the country situation and the sector. Other bilateral agencies also use innovative ways of leveraging private sector resources. Germany, for example, uses their development bank, KFW, for loans, including structured models with first loss schemes.

17. In the US, USAID does not carry out sovereign lending but works directly in development finance through the Development Credit Authority (DCA). Guarantees do not score as ODA but they facilitate financial flows to developing countries. Since its establishment in 1999, DCA has facilitated $2 billion of credit for 100,000 borrowers in 67 countries.

18. The Swedish Development Agency, SIDA, also has an innovative guarantee scheme for small and medium-sized enterprises, which underwrites working capital loans for trade. SIDA does this in addition to its ODA spending.

19. Using bilateral agencies to directly provide a wider range of financing instruments can also have disadvantages, for example higher transaction costs for recipients of aid due the need for them to negotiate multiple agreements, deal with multiple donor missions and report in a variety of formats.

20. As part of its economic development focus, DFID is expanding its use of loans, guarantees, insurance schemes and equity alongside grants and reimbursable grants (challenge funds), we are working closely with other donors to learn from their experience.

Question 6: How DFID should monitor and influence expenditure by multilateral institutions, including in regions and countries where DFID does not have bilateral programmes

21. DFID gathers information on multilateral performance from a wide variety of sources, including: evaluations, assessments by the Multilateral Organisation Performance Assessment Network (MOPAN) and other bilateral donors, feedback from DFID country offices, feedback commissioned for the MAR from NGOs, visits to non-DFID-focus countries, and evidence from multilateral organisations themselves, either obtained through our membership of governing bodies, or specially requested.

22. The range and quality of these sources varies across the multilaterals. Full organisational evaluations based on country case studies tend to take place only every three to five years, if at all. MOPAN assessments, which usually gather evidence from eight to 10 countries, are also on a three to five year cycle. Some organisations publish annual Development Effectiveness Reviews which synthesise information from across all of their operations, but many do not. DFID country office feedback, visits to non-DFID-focus countries, and feedback from NGOs are therefore important supplements to these other sources.
23. Core multilateral funding decisions are subject to the same programme management processes as other funding decisions in DFID. This includes annual assessments of progress against reform and results priorities, documented and published in Annual Reviews. Multilaterals are also being assessed this year through the MAR update process. This draws on information from all of the sources listed above, and compares and contrasts to draw out consistent messages. In some areas, the evidence base has been strong; in others, it has been weaker, and this will be set out clearly in the refreshed MAR assessments. DFID believes that the updates are a valuable assessment of the extent to which multilateral organisations have improved their performance since the MAR was carried out and published in 2011.

24. Individual bilateral projects and programmes delivered through multilateral agencies are also subjected to the same detailed scrutiny and the same business case process as all other bilateral aid. DFID spending departments are required to assess the strategic and tactical fit of the proposed programme, explore alternative options for delivering the same results, and analyse costs and benefits.

25. Gathering good quality evidence about in-country performance from across a wide range of countries remains challenging. DFID has focused on reforming MOPAN, so that it collects information on a wider range of organisations more frequently, and on accessing country office feedback from other bilateral donors with different country presence.

26. Influencing multilateral organisation performance takes place at different levels. The MAR has proved extremely successful as an influencing tool with MAR leadership. This impact has been amplified, as it has spurred others on to do similar exercises, often drawing on the UK’s MAR methodology (eg Australia, Canada) and/or data (eg Denmark). The multilaterals have been very constructively engaged with the MAR update—a clear indicator of how much it matters to them.

27. The UK is influential in the governing bodies of most multilateral organisations, partly because we are a relatively large funder and partly because our expertise is respected. However, the NAO noted in their report on DFID’s MAR published on 19 September 2012 that “they expected the Department to… tighten its approach to promoting and monitoring reform within individual agencies.” Going forward, the Department plans to do more learning around influencing multilateral reform, drawing on best practice on evaluating influence.

28. At country level, DFID offices who are using multilaterals as delivery partners engage with them to improve their performance and feed information back to the centre as necessary. The relationship between the DFID UK office and country offices has been strengthened considerably over the last two years, with the recruitment of three country engagement managers. This is enabling DFID to take a much more consistent and consolidated approach to monitoring the value for money and effectiveness across the board from using multilaterals to deliver bilateral aid, and a much stronger and more systematic approach to promoting reform.

June 2013

Further written evidence from the Department for International Development (DFID)

The International Development Act 2002 permits DFID to provide both grants and loans. The then Overseas Development Administration provided loans in the 1970s and 1980s but ended these facilities in the light of the debt crises of the 1990s switching to provision of grants only to sovereign governments. However given the changing context within which we work, including that the majority of the world’s poor now live in middle-income countries and resolution of the debt problems of most low-income countries, we are exploring whether we still have all the right instruments available.

July 2013

Further written evidence submitted by the Department for International Development

1. The context for UK development cooperation has changed considerably in the past decade. Strengthened country ownership, a growing awareness of the importance of engaging in fragile states, and increased emphasis on results and the need to be accountable to the UK public are just some of the trends which have transformed the way DFID carries out its business. Current discussions on the post-2015 development agenda will raise further questions about how UK development cooperation should be shaped. In responding to these challenges, there will be a need for strong leadership. The timing and scope of this inquiry are therefore very timely.

Question 1: How the main global factors affecting poverty and well-being are changing and how this will affect development cooperation

2. DFID undertakes regular Horizon Scans to explore how global trends will affect the development landscape over the next 10 to 50 years. These scans focus on the 28 countries in which DFID works, although consideration is also given to wider issues. Five main trends are highlighted in this memorandum.
3. One trend is that populations in developing countries are rising, fast. For example, between 2010 and 2050, Nigeria will grow from 158 million people to 390 million; Pakistan from 173 million to 275 million; and Yemen from 24 million to 61 million. These demographic changes are considered to be largely inevitable, although family planning services, and policies that give choice to women over their fertility, can still affect the precise magnitudes and timings.

4. A second trend is that many developing countries are urbanising. Projections suggest that, by 2030, both Africa and Asia will be more urban than rural, with much of this urban growth in small towns and cities. These trends run the risk of creating cities that are poorly-planned and under-serviced, with high inequality and large, young populations, with attendant negative welfare and climate implications. However, unlike demography, urbanisation trends are not inevitable and the pace of change can be affected by policy and investments. This offers opportunities for governments and development actors to ensure urbanisation is characterised by low carbon development, more efficient service delivery and poverty reduction.

5. The combination of demographic change and urbanisation also offers a unique opportunity to increase prosperity in developing countries. Young populations and low dependency ratios ("the demographic dividend") mean the economy has higher potential productivity, whilst urbanisation means easier access to jobs and public services. Urban medium- and large-scale enterprises also tend to be the most productive and offer the highest returns to labour; creating a sufficient number of jobs in such enterprises will therefore result in enormous welfare gains for developing countries. However, trends do not seem to be moving in this direction; even in Ghana, a strong performer in poverty reduction and growth, it is the least productive worst-paid jobs that are expanding fastest. There is therefore a role for donors in encouraging diversified growth paths that promote sustainable poverty reduction.

6. A third trend is the increasing impact of climate change, with the International Energy Agency forecasting the world is on track for temperature rises of 3–6°C by the end of the century, unless new policies are introduced. There will be a significant adverse impact on development and economic growth, with some regions facing a range of challenges including decreased water availability and agricultural yields, increased exposure to malaria and a higher risk of flooding, although other regions may benefit (eg from increased agriculture). Africa is particularly likely to suffer due to the impact of poverty in restricting choices for response. Tackling the causes and impacts of climate change will therefore be a priority, with a focus on win-win solutions (such as low-carbon investments) which also contribute to poverty reduction.

7. A fourth trend is resource scarcity. On the positive side, there has been a mineral and extractives boom in Africa; already the world’s top producer of many mineral commodities and with the world’s largest reserves of many more, much of Africa is still to be mapped. Africa also has around 10% of proven global crude oil reserves and 8% of gas reserves, with recent discoveries adding to the total. As far as access to food is concerned, only one-tenth of the world’s land surface is used to grow crops. A further 40% is grassland (of variable quality) and forests, some of which could be converted for agriculture. It is also estimated that, using current technologies, average yields in many parts of Africa could be increased two- to three-fold.

8. However, global growing demand for natural resources such as water, energy and land may lead to critical scarcity in some areas. For example, by 2025 parts of northern Africa may have withdrawn more than 40% of available water; and the emergence of three billion global middle class consumers by 2030 will further fuel demand for these resources. These scarcity trends can overlap to create stress points, with more recent conflicts occurring in these areas of multiple stress. Addressing this issue is therefore a priority for development actors.

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1 World Population Prospects 2012
2 ILO, Key Indicators of the Labour Market, 2012
3 World Urbanisation Prospects, 2009
4 World Urbanisation Prospects, 2009
5 Nsowah-Nuamah, Tee, Awoonor-Williams (2010)
6 See, for example, the 2006 Stern Review
7 Estimates of available land vary enormously due to different methodologies, diverging views on how much cultivated land is degraded and whether forests are counted as available for arable land. FAO-UNEP have suggested there is only 12% more arable land available worldwide that is not either forested or subject to erosion or desertification. In contrast, Buringh and Duda estimated in 1987 that only 77% of potentially arable land in developed countries is already cultivated and as little as 36% in developing countries. See Evans, A. The Feeding of the Nine Billion: Global Food Security for the 21st Century (Chatham House, 2009), pp.20–21.
8 Foresight Global Food and Farming Futures, p.80.
9 UNEP
10 OECD
11 Stress Zones (DCDC Strategic Trends, 2007)
9. A fifth trend is increasing access to technology. Currently four of every five mobile connections are made within the developing world, and it's estimated that 80-90% of people in some poor countries have at least minimal access to a mobile phone. In terms of internet access, sub-Saharan Africa recorded growth of 500% between 2000 and 2011. These technologies provide a number of opportunities to strengthen the impact of development cooperation, including through opening up governments and increasing citizen participation, improving the delivery of vital services, boosting economic opportunities and making aid smarter.

Question 2: The role of development aid in the future

10. Alongside the global trends set out above, the financing needs of developing countries are changing. This is due partly to the economic growth, partly to increasing domestic sources of finance (savings and taxation), and partly to the rise of alternative funding sources (both public and private) and increasingly lucrative interactions with emerging powers. From 2002-07, domestic revenues in sub-Saharan Africa grew from 70.5 to 201.8 billion and private flows grew from 9.7 to 53.3 billion. Meanwhile, between 1980 and 2010, trade between emerging powers and DFID-focus African countries increased by 40,000% and 10,000% for oil-exporting and non-oil-exporting countries respectively, and Chinese foreign direct investment stocks in these countries were $13 billion by 2010.

11. The impact of these changes is that ODA flows are relatively smaller as a proportion of total financial flows to developing countries than in the past. Different funding sources can also play different roles—for example, use of domestic resources to fund recurrent expenditure, whilst private sector finance focuses on productive expenditure and private philanthropy encourages innovation. This offers an opportunity to use ODA to unlock, shape and complement these wider financial flows, in order to address the risks and opportunities outlined in Section 1. One issue, particularly for multilaterals, is the potential role of ODA in promoting global public goods.

12. A further important factor affecting the role of development aid in the future is the geography of poverty. Low Income Countries (LICs) have systematically higher rates of poverty as a percentage of the population than Middle Income Countries (MICs). However, around two-thirds of the world’s poor currently live in MICs, highly concentrated in India, Nigeria and China. Internal DFID analysis suggests that whether global growth is fast or at 1990s rates, extreme poverty will continue to be predominantly in MICs over the next 20 years (with 60-75% of MIC poor in India and Nigeria).

Question 3: Whether DFID should offer concessional loans, and the balance between these and traditional grant aid

13. The vast majority of UK bilateral ODA is currently provided in grant form, with the exception of non-grant ODA provided through CDC—and approach that has been broadly similar since the mid-1980s. However, other donors take different approaches; France, Germany and Japan provide between 18% and 54% of their bilateral ODA as non-grants while the US provides just 1%. Donors who give a larger proportion of non-grant aid generally use a bilateral development bank to deliver their loans. These banks are able to borrow commercial funds to leverage the publicly provided capital. The use of non-grant instruments is heavily weighted towards productive sectors; on average 15% of bilateral ODA flows to economic infrastructure, but the figure is 56% for non-grant instruments.

14. DFID currently provides grant support to a number of intermediaries who in turn use non-grant instruments, the largest of which are the multilateral development banks. Increasingly DFID has been using intermediaries to deliver innovative non-grant instruments in its private sector work. Non-grant instruments have a number of potential advantages in terms of value for money, including enabling funds to be recycled, allowing donor finance to receive its share of any upside realised and leveraging in private finance to support development outcomes.

Question 4: The impact of non-aid policies and instruments, including trade, migration and climate on development, and how effective cross-Government work on these is

15. According to the Centre for Global Development’s Commitment to Development Index, which ranks 27 of the world’s richest countries based on their dedication to policies that benefit poor nations, the UK currently ranks 9th (compared to 2011, when we ranked 12th out of 22 countries). Moreover, the UK Government scores

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12 https://wirelessintelligence.com/analysis/2010/10/developing-world-accounts-for-four-in-every-five-mobile-connections/230/)
13 Zuckerman (2009)
14 http://www.internetworldstats.com/stats1.htm
16 UNCTAD (2012): These magnitudes are so large because they start from a very small base, but do reflect a real and large increase in the strength of these economic relationships.
17 2010 Statistical Bulletin of China’s Outward Foreign Direct Investment
18 World Bank, Global Poverty Update, March 2012
19 OECD DAC, International Development Statistics
particularly highly on promoting investment in poor countries, demonstrating it is looking at long-term measures to enable developing countries to escape from poverty.

16. With regards to trade, the stalling of the Doha Development Round has resulted in a growing trend towards bilateralism, with the risk that poor countries will be largely excluded from the negotiations that will define future rules and standards. The case for open markets was also made more challenging by the 2008 crisis, and protectionist sentiments in developed economies are being reinforced by increasing competition from Asia and other emerging markets. The increasing complexity of the global trading system has underlined the value of the UK’s joint DFID/BIS trade policy unit which is able to bring together development and national concerns in one place, and ensure the interests of poor countries are not neglected in these new negotiations.

17. The links between migration and development were discussed in the IDC’s Sixth Report of Session 2003–04 on Migration and Development: How to make migration work for poverty reduction. Internationally, the Global Forum on Migration and Development offers a process through which states affected by international migration can meet to discuss common concerns. DFID is the lead UK department on migration and development, and liaises closely with the FCO and Home Office on inputs to these discussions.

18. On climate change, the UK is working hard to agree a global deal covering all emissions as the most effective way of tackling climate change, and reducing the adverse impacts on climate change on development. We are also working to ensure that any deal, and the policies and frameworks within it, is structured in a way that takes account of the capacity of countries to act. The UK formulates such policies across Whitehall, with DFID playing a key role in ensuring that the impact on the world’s poor is considered throughout. DFID also works jointly with other Departments in overseeing implementation of the £2.96 million Investment Climate Fund and in the new climate units established in HM Government’s Embassies in Delhi and Jakarta.

19. Other non-aid policies which impact on prospects for development include domestic and international policies on tax collection and transparency and accountability. Some action can be taken to address these issues through the provision of development assistance. However, other actions require agreement across Government Departments. The UK’s forthcoming Presidency of the G8 provides an opportunity further to strengthen cross-Government working on these important issues.

Question 5: How the UK works with international organisations and other donors, and its ability to influence the future global development agenda

20. With permanent membership of the UN Security Council, the Commonwealth, the EU, the G8 and the G20, and a strong and respected tradition of commitment and expertise on international development, the UK is well placed to help to shape the future global development agenda.

21. The UK works extensively with international organisations, in partnership with others, to achieve our development and humanitarian objectives. Multilateral organisations provide a critical complement to our bilateral work. They provide a fast, effective response to humanitarian and security situations, and financial support to help cushion poor countries from economic shock. They deliver aid on a large scale to a broad number of countries, have the power to broker international agreements, set international standards on cross-boundary issues, and make a substantial investment in research, analysis and dissemination. By working through multilaterals we can achieve development outcomes and influence the global development agenda in ways that would be difficult to achieve bilaterally.

22. HMG works with multilateral organisations in three main ways—(i) as shareholders and/or providers of core funding (in 2011–12, 44% of DFID’s programme expenditure was delivered in this way), (ii) as funders of specific programmes through our bilateral work, and (iii) as contributors to international development policy debates (for example, working with UN agencies and the World Bank in providing analysis to help shape the successor to the MDGs). The March 2011 Multilateral Aid Review was critically important in highlighting the weaknesses as well as the strengths of the multilateral system, and a September 2012 NAO report noted that the MAR has contributed significantly to promoting reform in the multilateral organisations. DFID also works extensively with international organisations and other partners to reshape and re-energise the international system, developing new partnerships and leveraging new sources of finance.

23. DFID also engages with a range of other bilateral and non-governmental donors to achieve its objectives; for example, at the Family Planning Summit the Gates Foundation doubled its support alongside the UK. Bilateral agreements are in place with a number of countries including the US and France to work together to achieve common goals. The UK’s Presidency of the G8 in 2013, the Prime Minister’s role as co-chair of the High Level Panel on the post-2015 framework and the Secretary of State’s role as co-chair of the Global Partnership for Effective Development Cooperation also provide specific opportunities to help shape the future development agenda with others.

24. DFID has also begun to work in partnership with emerging economies, such as Brazil, China, India, South Africa and the Gulf States, on promoting development in low income countries and addressing global development challenges. These countries are having a significant impact on development of low income countries and are active contributors to discussions in international fora on poverty reduction and global development. DFID has signed Memoranda of Understanding with Brazil, China and the United Arab Emirates and has in place a number of joint programmes combining UK expertise and emerging power experience.
25. As noted above, the context for development cooperation will be changing significantly in the coming years, and it is important that the UK is fully prepared to respond. DFID is currently focussing a significant amount of its attention on three priority issues:

(i) securing a global agreement setting out the post-2015 development agenda. Securing agreement to a new international framework will ensure international efforts to eliminate extreme poverty will be better coordinated and focused on an agreed set of goals.

(ii) delivering the results and commitments we have agreed in delivering the current set of MDGs, as part of the Spending Review. Ensuring the UK has a strong track record on results allows us to demonstrate our comparative advantage.

(iii) constantly assessing and strengthening the value for money and evidence base of our programmes, with plans already underway to update the MAR in 2013.

26. Work is also ongoing in the run-up to the next Comprehensive Spending Review on future priorities and the future shape of the organisation, taking account of changing needs at the global, regional, national and local level. DFID stands ready to update the Committee as this work progresses.

November 2013

Written evidence submitted by CDC

Introduction

1. CDC’s experience lies only in making investments into the private sector in developing countries and the financial instruments DFIs use to contribute most effectively to the growth of the private sector. This submission will not, therefore, address areas of the Committee’s Inquiry that fall outside these areas of expertise.

About CDC— Who we are

2. CDC is the oldest development finance institution (DFI), established in 1948. Wholly-owned by government, it is part of the Department for International Development’s (DFID) private sector strategy to alleviate poverty, but operates independently under the governance of an independent board. CDC aims to achieve positive impact where we invest, primarily by creating jobs, while also achieving a fair return on capital. It is a measure of CDC’s success that it does not draw capital from the UK taxpayer, but invests from its own balance sheet and recycles profits into new investments.

About CDC— What we do

3. CDC supports the growth of businesses and job creation across all of Africa and South Asia—especially in the harder places. We aim to invest where our job creation focus can have greatest impact: in countries where the private sector is weak and jobs are scarce, and in sectors where growth leads to jobs—directly and indirectly—such as manufacturing, agribusiness, infrastructure, financial institutions, construction, health and education.

4. CDC invests to support the growth of all sizes of business from the micro-level right up to the largest because we believe that a balanced private sector is necessary for economic development and robust job creation. In doing so we like to demonstrate that it is possible to invest successfully in some of the harder places in the world. We aim to avoid providing capital where it is clear that fully commercial capital is plentiful.

About CDC— How we Invest

5. CDC provides capital in many forms, including equity, debt, mezzanine and guarantees, and this capital is typically used for growth. We invest directly and through fund managers that we believe are aligned with our aims.

6. CDC invests capital to support the growth of private sector businesses and job creation across all of Africa and South Asia. We aim to invest where we can have greatest impact on job creation: in countries where the private sector is weak and jobs are scarce. Our focus is on sectors where growth leads to jobs—directly and indirectly—including manufacturing, agribusiness, infrastructure, financial institutions, health and education.

7. Unless businesses are economically and commercially sustainable, no impact can ultimately be achieved. To provide decent, long-term jobs a business must be financially sustainable and be run profitably, for the following reasons:

— Profits enable companies to invest in training, R&D and expansion, as well as ensuring that they can withstand shocks such as the loss of a large customer.
— A profitable company can survive without the on-going support of DFI capital and succeed in attracting other investors to finance its growth.

— Making investments on commercial terms not only ensures that the jobs we help create are likely to endure over the long term, but it also demonstrates to other potential investors that reasonable returns can be made in difficult geographies.

8. Investing profitably also enables CDC to be self-financing. When CDC’s investments and loans generate positive returns these are recycled back into future investments. This model means CDC has had no new capital from government since 1995 and doesn’t cost the taxpayer a penny.

**Concessional Loans**

9. There can be many benefits to concessional finance made to public sector projects on a multi-lateral or bilateral basis. In particular, concessional finance is used effectively by multilateral and bilateral development banks, such as the World Bank or KfW, where the focus is on public-to-public co-operation. The loans are granted to organisations such as public utilities, municipalities, state-owned banks or directly to governments. Another existing model is where concessional loans are being provided to APEX institutions such as state-owned development banks or central banks, which then offer special lines of funding to private local commercial banks. However, in both cases, the loans are provided to public entities and normally come with an explicit government guarantee. Whenever private entities, such as commercial banks or private companies are involved, the provision of concessional funding has to be equitable and accessible to all qualifying entities in order to avoid market distortions.

10. A recent discussion between European DFIs regarding the potential benefits and impact of concessional finance (where the concession was achieved by blending loans and grants) noted the following benefits:

— The ability to leverage development finance allowing donor countries to do more with less;

— The potential for greater aid/development effectiveness and potential economies of scale generated as a result of better pooling of resources and co-ordination among development financiers;

— The potential for enhancing the partner country governments’ ownership of the development assistance due to the loan component; and

— Potentially increased value added for developing countries, in terms of private sector development (notably banking and financial sectors) and demonstration effect.

11. At this discussion, the following questions and concerns were also raised as to their effectiveness, development impact and potential distortive effects. Specifically:

— The risk of financial incentives outweighing development principles;

— The risk to differentiate in favour of middle-income countries against poorer countries;

— Risk of crowding-out private financing and distorting markets;

— The risk of providing insufficient attention to transparency and accountability;

— The risk of unclear or ill-defined monitoring and evaluation methods; and

— The debt risks for developing countries of increasing lending.

12. For more information on these points please see Krätke, F. 2013. From Purse to Policy and Practice. Six initiatives to future-proof EU development cooperation for 2014-20 and beyond (ECDPM Briefing Note 51, publication date 6 June 2013).

**Provision of Concessional Finance by new UK Development Bank**

13. CDC has no view on whether an independent development bank would be needed to provide concessional finance, as opposed to DFID offering such products directly. However, it is important that clear differentiation is maintained between private sector promotion, which largely should not be done via concessional finance, and public financial co-operation.

June 2013
Written evidence submitted by Caroline Ashley

Engagement with the Private Sector, Development Finance and other Instruments

1. Given the Committee’s interest in how UK development cooperation can engage effectively with the private sector in developing countries, this submission draws on practical experience in a range of development initiatives—including challenge funds—that directly collaborate with the private sector in Africa and Asia and seeks to provide a view from the ground.

2. The first section considers different reasons for engaging with the private sector and what instruments may be appropriate. The second section considers institutional implications of private sector engagement.

3. The main conclusions are that concessional finance for private sector growth are one possible instrument and one possible objective, but others should not be ignored. There is much that donors can do to support a “better” private sector not just a “bigger” private sector by carefully applying public funds—and DFID is already active in this emerging space. Though finance is needed, a range of instruments are useful.

4. Whichever objective and instrument are selected, there are organisational and operational challenges for a donor organisation engaging with the private sector. These are not insignificant.

Unpacking Assumptions about Objectives and Instruments

5. Discussion of private sector engagement from a development perspective can be plagued by three generalisations: there is a tendency to speak of “the private sector” as a monolith (rather like “the poor”); an assumption that the obvious donor instrument is finance; and an assumption that the best measure of success is jobs. I would suggest that all three generalisations require scrutiny and nuance.

Unpacking the “Private Sector”

6. Poor people engage with many types of private company in many different ways, from being small-scale private sector actors themselves (farmers, traders), to buying brands that they trust (for their soap or seeds) or shoddy goods that are all they can afford, and seeking employment in local firms or distant factories. Their private sector engagement is far from perfect. Many lack income and access to employment. Their own informal sector activities are constrained by shallow or distorted markets. They lack access to affordable quality goods. Medicines, water and energy are often purchased privately rather than provided publically at disproportionately high cost for low quality.

7. The implication is that there are many ways in which “private sector development” can influence livelihoods of the poor. For example:
   - Business investing in goods and services appropriate to low-income consumers can boost access and affordability of livelihood essentials.
   - Improving the trading environment can enable informal sector workers and entrepreneurs to achieve efficiency gains.
   - Expanding business activity can boost access to jobs, or to markets for their produce.

Therefore there can be a number of different development objectives for a donor engaging with the private sector.

Unpacking Objectives and Instruments of Private Sector Engagement

8. Broadly speaking, objectives of private sector engagement lie on a continuum, illustrated in Figure 1. At one end, “bigger”: expansion of the private sector, via investment, to achieve faster growth, and ergo jobs. At the other end, “better”: changing how companies work, so growth is more inclusive and solutions to poverty get innovated and scaled. The former is generally familiar. The latter may be less so but includes:
   - Public private collaboration on public goods, such as nutrition, vaccines, carbon emission reduction.
   - Facilitation of “inclusive business” models, which generate both commercial return and direct gains for low-income people as producers, entrepreneurs, employees or consumers.
   - Impact Investment, which seeks investments that generate both commercial and social return.

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20 Director, Ashley Insight Ltd
21 Current work as Results Director of the Business Innovation Facility covers engagement with over 100 companies in Africa and Asia. A similar role in Sida’s Innovations Against Poverty reaches another 50. I also lead on results for the new DFID IMPACT programme, supporting impact investment. Previous work since the nineties, included work with the tourism sector and on wider issues of private sector in development. I have never worked within DFID but much of this has been in collaboration, funded or commissioned by, DFID.
9. Intervention at any part of the spectrum can have catalytic effects: first round success leads to further investment or innovation by others and changes in how markets work.

10. This analysis is important because it is too often assumed engagement with the private sector is just about jobs and growth. It’s not. It varies. Clarity of objective helps ensure the right instrument and indicators are chosen.

11. This sounds totally obvious, but it’s remarkable how often I am asked about the number of jobs created by companies supported by the Business Innovation Facility (BIF). Funded by DFID, the Facility has spent around $4 million on support to companies developing “inclusive business”. They are developing mobile trading or soil testing kits for farmers, quality education for rural schoolchildren, clean toilets in slums, gas stoves affordable by the poor, and much more. Direct job creation is meagre, but also misses the point.

SELECTING INSTRUMENTS FOR PRIVATE SECTOR ENGAGEMENT

12. Where “bigger” is the main objective of private sector engagement, finance for investment is one obvious instrument. Others include building infrastructure, banking systems, legal systems, and unblocking physical or regulatory impediments to trade. Finance on its own is insufficient.

13. Where “better” is the main objective—and is the main focus of my work—finance can again play a role filling a big gap. But tailor-made tools and more than finance are needed. Catalysing business growth that is pro-poor requires risk-sharing, technical assistance, policy engagement, partnership brokering, market building, cross-fertilisation, sector-specific engagement and patient finance.

14. There is evidence that more and more companies are embarking on business initiatives that can be described as inclusive business, creating shared value, or contributing to public goods. They do so for long-term strategic commercial reasons. But the returns are slow and the process is painstaking. Given positive externalities, risks and uncertainty, there is clear scope for application of public funds for development objectives.

15. The value of technical assistance has been highlighted by the experience of the Business Innovation Facility. BIF supports individual companies directly, but with technical assistance not money. Approximately 50 companies have each been supported with around £50,000 of DFID-funded technical assistance (TA) and as many again received shorter term support. The TA is targeted at helping an “inclusive business” build a sustainable business model. Feedback from companies suggests that:

— The pool of companies that see the immediate need for technical support is smaller than the pool of companies that seek grants.

22 www.businessinnovationfacility
— But the value of TA when timely and targeted is high: it can help entrepreneurs build a more robust business model, avoid mistakes, be more attuned to the needs of the poor, deliver proof of concept for internal financing, or get the business investment-ready. Short one-off inputs can have long-term affects.
— TA that comes from a donor-programme has added value, because of the credibility it brings, which in turn helps open other doors.

16. Other organisations increasingly provide TA alongside finance. DFID is unusual however, in having a facility that offers only TA in this field.

17. However, the shortage of finance is not resolved by TA, and is undeniable. Many companies supported by BIF reach the need for expansion or working capital but despair of local banks and traditional investors. Take the example of Furniture Village in Nigeria: an innovative proposal for a cluster of artisanal furniture makers and a furniture store, developed by a leading business woman in Nigeria. The CEO herself sits on boards of many banks in Nigeria, so the fact that she could not raise finance within Nigeria for Furniture Village is clear testament to the fact that domestic finance is not ready for the risks and innovation of inclusive business.

18. There is high demand for finance that is targeted at inclusive business. Many of the companies supported by the Business Innovation Facility and Innovations Against Poverty report problems in accessing the right kind of finance. At the African Enterprise Challenge Fund, no more than one in ten proposals secure funding (grant or loan). Earlier this year, CDC ran a Request for Proposals for the new Impact Fund, funded by DFID.23 Open to funds operating in Africa and Asia, applications topped 120, with 80 focusing on Africa.

19. These example highlight demand for impact investment where investors are willing to take a slower or lower financial return because social value is created. There is some debate, however, whether the biggest gap is in supply or demand. While entrepreneurs bemoan lack of finance, it is common wisdom amongst impact investors that a lack of investable propositions is a major constraint. Both perceptions have validity. The market simply does not work well yet— they cannot find each other. And what is offered and needed are not quite the same: early stage funding, to help companies be ready for larger inputs, is scarce.

Implications and Institutional Issues for Donors Engaging with the Private Sector

Comparative Advantage

20. DFID has been “ahead” on Private Sector engagement and particularly on inclusive business and impact investment, compared to other donors. It is seen as willing to engage, take risks, try new approaches. Staff have been creative and adaptive. DFID is adding value and has a comparative advantage on which to build.

21. DFID is already investing and testing in impact investment. While the amount may be small relative to the mainstream, it still represents a major change over the past year. The impact investment market is evolving quickly but few other donors or DFIs are so focused on it.

22. Several other donors have development banks. Relatively few specialise in impact investment. While some DFIs would argue that everything they do can be defined as “impact investment” I would disagree. Indeed, preliminary indications from the Impact programme are that there is a clear difference between the objectives of Impact and objectives of a more traditional DFI. The social return is much more important for most impact investors. From the first months of impact, I would also observe that the impact investment approach is also quite different to standard practice for CDC.

23. A small but growing minority of other donors are now active in inclusive business or variations on the theme: GIZ, IFC, Sida, JICA, USAID, AusAID. DFID, which started with challenge funds over a decade ago, has already reached the post-hype stage, has a range of programmes completed or operational, and would be well set for a proper state-of-art review to for designing the next generation of support.

24. DFID is good at piloting in general and in this space. Arguably performance is more variable on applying staying power to build on lessons and scale what works. The areas of inclusive business and impact investment are both rich seams with more results to be reaped.

Internal or External Management?

25. The Committee is interested in whether development finance is best run inside DFID or externally. While I cannot comment on that, I have observed the “clash of cultures” between public and private sector and the advantages of out-sourcing direct private sector support to an external firm (BIF is managed by PwC, the Impact Programme is run by CDC and PwC):
— Finalising contracts can become a vast task engrossing legal departments. Typical clauses in DFID contracts (such as on Intellectual Property Rights) have been known to kill off an emerging engagement.

23 http://businessinnovationfacility.org/the-impact-programme
— Due diligence can be another vast task, run-of-the-mill for banks and auditors, but probably much tougher in a civil service setting.

— Culture is hard to define, but differs: accountability is critical in the civil service, whereas an investor may give a company its decision to invest on the same day. Both DFID and companies are used to being treated as “clients,” but clients expect others to fit into their pace, not vice versa.

Whatever mechanism is used, combining development and private sector expertise is critical, and can be highly productive.

### Challenges and Risks

26. The biggest “misfit” between DFID’s procedures and the necessities of private sector engagement is programmatic duration. To truly achieve and measure development impacts from private sector support, a minimum of six years is needed; 10 is ideal. A best guess is that an innovative inclusive business takes two to three years of iteration, three to five years to operate and then scale, and sometimes longer. Most DFID programmes simply do not last that long. There are welcome departures however: the Impact Programme—where funds are committed via CDC—is planned for 13 years, and M & E will continue throughout.

27. A corollary of this misfit is that monitoring and evaluation (M & E) is important but may be slow to yield results. I am told that PIDGE provides a good example: after the first two to three years, most of the companies looked like failures. Fortunately this is another welcome example where DFID are taking a longer time-frame. The implication is that pressure for good M & E is helpful; pressure for quick M & E evidence is not. M & E that is not just project-based, but reviews all DFID engagement with the private sector is probably needed to generate true evidence of value. Ex post M & E still seems to be rare in this space but is definitely needed.

28. There are donor risks from private sector engagement. Reputational risk is the most obvious: a company culprit is revealed to have DFID support. This risk can be reduced but not removed.

29. Two more common risks are:

— Risk of business failure. If public subsidy is used to buy down risk of an investment which the commercial market won’t support, there is self-evidently a risk of business failure. 100% success would suggest public subsidy is not best used. But tolerance of “failure” needs to be explicitly built into metrics.

— A more subtle risk is that when a donor engages with a company it is not in control. The logic of the intervention relies on business success, which requires rapid adaptation to challenge or opportunity. The means used will vary from the initial plans agreed. I have seen DFID donors truly struggle with this. What matters is that the development gain (whether defined as jobs, ports, innovation, or clean water for the poor) are achieved. But being clear on ends and flexible on means can be challenging.

30. The implications is that two things are needed:

— willingness to take risks. Again this sounds obvious but it depends on institutional structure. There is some concern that a DFID culture in which process and results are increasingly emphasised may inhibit ability to take risks; and

— careful management of expectations (of leaders and commentators), clear logic and strong M & E.

31. “Hype” is itself a problem in this space. Private sector engagement and inclusive business have both suffered in recent years. Hype feeds the critics: straw men are easily built up and knocked down, when the hype is not sufficiently nuanced about the good bad and limitations of private sector in development.

32. Public perception and mis-perception is a challenge for donor engagement with the private sector. There is no easy solution, but it will have to be tackled if this becomes a more major plank of development cooperation. Four suggestions:

— Clarity of objectives: that the private sector is not an end in itself, but a means to a raft of important development goals.

— Clarity of logic, particularly around the role of profit: usually the logic chain for development via the private sector involves profit (not CSR). For example, DFID supports companies that are innovating commercial solutions in clean water and energy that meet the needs of the poor. The logic is that a solution that is both profitable and pro-poor will go to scale at much less cost than a subsidy-driven solution. Profit is not an unfortunate side affect, it is crucial to reaching scale. Clarity of logic is the first—though admittedly not the last—defence against simplistic critiques.
Building on Innovation

33. DFID is an innovator in this space. This lays a strong basis for further building private sector engagement into revised cooperation plans, and for continued innovation. My recommendation would be not just to put large amounts of money through concessional finance, but to keep innovating and shaping. The recommendation for innovation however comes with two caveats:

— Innovation for the sake of it, or repackaging for new political news, should be avoided. Businesses get wary of new announcements.

— Innovation is a management and cultural issue. What applies to companies can apply to DFID too: innovation needs to be cultivated and built upon. This requires space to test approaches, pressure not to deliver quickly but to deliver lessons on what to scale up and why. "Innovation management" is both an art and science these days. While DFID is supporting innovation externally, it will also need to cultivate it internally. Building an institutional structure that cultivates innovation is difficult, in both private and public sectors.

Conclusion

Engagement with the private sector is likely to be an ever-increasing part of future development cooperation. There are good reasons for this as a number of development objectives (though certainly not all) can be achieved through the private sector. However, to maximise development impact and build on DFID’s comparative advantage, it is important to consider approaches that promote “better” not just “bigger” business. New business models are emerging that directly benefit low-income people but need public support. Finance, particularly impact investment, is needed, but is insufficient on its own.

DFID is already an innovator in a range of tools, including technical assistance, that harness private sector contributions for development, and continued innovation is important. Expanding this work will mean taking on board the various risks and challenges of private sector engagement, being extremely clear on the logic, pros and cons of this work.

August 2013

Supplementary written evidence submitted by Caroline Ashley

Businesses that Supply Life-Enhancing Goods and Services to Low-Income People

1. Mr Jeremy LeFroy MP requested some detail on the businesses that I mentioned, that supply essential goods and services that are targeted at low-income people. Each of these is an “inclusive business” meaning it aims to generate a commercial return and directly engage people at the base of the economic pyramid as consumers, producers or entrepreneurs.

Examples

2. **Oando is producing and selling a liquid petroleum gas stove**, designed for the mass market in Nigeria. Oando is a major Nigerian energy company. The standard lpg stove is much larger, this O-gas version is smaller, cheaper, transportable and in every way designed to meet the needs of low-income households, most of whom cook with kerosene or fuelwood. Benefits include reduced indoor pollution, faster cleaner cooking, and cost savings compared to kerosene. Micro-finance makes it affordable. Photos and details at: http://businessinnovationfacility.org/page/project-profile-oando-affordable-clean-cooking-fuels-for-househol

3. **iSchool is putting the entire Zambian curriculum online, using an enquiry-based learning approach**, and developing strategies that make it affordable for state and community schools. The aim is not just to help schools use IT, but shift teaching away from rote learning. Literacy numeracy and critical thinking have all increased in the pilots, compared to schools in the control group. The company is a start-up by an IT entrepreneur. iSchool’s commercial launch is this month, September 2013. http://businessinnovationfacility.org/page/project-profile-ischool-internet-connectivity-in-zambian-schools

4. **mKRISHI is a range of mobile phone based applications for Indian farmers.** It provides personalised advisory services, such as guidance on pesticide in response to a photo of crop pests. It is expanding to include trading platforms for agri inputs, such as fertiliser, and for sale of crops. mKRISHI is an initiative of Tata
Consultancy Services, part of the Tata conglomerate who are making long-term investment in this innovation, with an expectation it will break even in a few years. http://businessinnovationfacility.org/page/project-profile-mkrishi-mobile-technology-for-farmers-in-india

5. Universal Industries in Malawi is developing a new product, high quality cassava flour (HQCF) based on sourcing fresh cassava from smallholder farmers. This provides a new product line and a substitute for imported wheat for the company, and a new source of income for local farmers. Supply chains to source from farmers need to be established, and NGOs are involved. http://businessinnovationfacility.org/page/universal-industries-high-quality-cassava-production-malawi-1

6. The Business Innovation Facility has supported around 100 such businesses with technical support, and they are profiled on the Practitioner Hub on Inclusive Business, www.businessinnovationfacility.org. The sister programme, Innovations Against Poverty, funded by Sida, has supported around 50 inclusive businesses with grants so far, also profiled. Businesses can also be viewed across both programmes by country, sector (eg energy, agriculture) and by theme (eg climate-friendly).

**Options for Managing Private Sector Finance, Inside or Outside DFID**

Many of the committee’s questions focused on whether finance for companies could be managed inside DFID or is best run outside, by a development bank. Leaving aside the questions of which types of business to support, on reflection I found it may be helpful to crystallise 5 options.

| Table 1 |
|----------------------------------------|----------------------------------------|
| OPTIONS FOR INSTITUTIONAL MANAGEMENT OF EXPANDED DEVELOPMENT FINANCE |
| **Option 1: run development finance from inside DFID** |
| Can easily be joined up with wider development policy, and coordinated with other instruments. | Would need to import specialist skills in investment design and management and build a dedicated cadre. Processes required, such as due diligence, risk management, contracting business, may not fit easily in a government department. Inefficiencies likely. |
| **Option 2: devolution/contracting out programmes and windows for external organisations to run** |
| This already works well for a number of challenge funds and windows. Combines DFID leadership and regular engagement with core competencies of firms that do private sector transactions and finance. | Scaling the current model may prove difficult. Managing multiple windows can be complex. There are inefficiencies from spreading DFID’s private sector engagement across many organisations. |
| **Option 3: expand the focus of CDC** |
| CDC is already well established and has specialist expertise in private sector finance. Confusion about the role of different types of DFID finance could be minimised. | CDC excels at its current specific mandate, but the various types of development finance being discussed seem to be a considerable shift. Governance structures are such that CDC runs fairly independently within a mandate set by DFID. |
| **Option 4: set up a new development bank** |
| A dedicated institution that over time can become the DFID institution for a UK approach to public and private development finance, with consolidated expertise and able to sit alongside its bilateral and multilateral “peers”. | A major set-up cost. Confusion with CDC’s role? Would presumably lead to a focus on finance—would DFID’s comparative advantage in qualitative and non-financial private sector support be utilised? |

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25 Projects landing page is: http://businessinnovationfacility.org/page/projects-landing-page-template
26 In the oral evidence session, I was asked if this would need to be on secondment. On the basis that investment specialists could not be “mainstream” DFID civil servants, I said yes. On reflection, they need to be a dedicated cadre for investment management with a long-term role in the investment and subject to incentives for the performance of their investment. This means secondments would be inefficient and a dedicated cadre is needed, albeit specific to finance and separate from the generalist cadre.
27 For example, the Business Innovation Facility is run by a consortium led by PwC. The African Enterprise Challenge Fund is outside DFID, funded by a number of donors, and managed by KPMG.
28 CDC focuses on commercial investments in private enterprise in developing countries that generate a commercial return. Although CDC is now managing the DFID Impact Fund, which aims to generate social return with a minimal commercial return (roughly preservation of capital), this is a distinct and small entity, off the CDC balance sheet, using different mechanisms and different staff.
Main advantage | Challenges
--- | ---
— How would DFID development objectives be aligned and coordinated?
— Would non-financial instruments for private sector support sit inside or outside?

Option 5: channel money via multilateral institutions

The most effective instruments can be supported at low transaction costs. Repayment of loans does not affect UK oda levels.29 — Less DFID control. Less opportunity to build on DFID’s comparative advantage. Likely more focus on mainstream business. Volumes may be such that it is simply boosting multilateral spend.

Certainly there is no simple answer to the institutional question. In any option, the critical issues are to establish governance arrangements and a blend of skills to combine development objectives with efficient private sector engagement, and to establish the clear logic and foci for DFID investment.

Neglected Issue? Impact Investment

On reflection, I was surprised that the evidence session on private sector engagement did not cover the issue of “Impact Investment” at all. Impact investment is a type of private sector finance which actively seeks social return as well as commercial return. The social return can be direct benefits to people at the base of the pyramid (as per the examples given in section 1) or can be public goods such as climate-friendly growth and public health. The commercial return is often sub-market, or is slow, requiring patient investment.

In the context of discussion about how to combine investment with development objectives, and how to build up DFID’s comparative advantage, I would suggest this warrants further investigation. DFID is currently investing £100 million through the Impact Programme.30 While scope to expand this immediately may be limited, while lessons from this initiative emerge, over time there is vast potential.

Written evidence submitted by Philip Schluter, Managing Director Schluter SA/Schluter Ltd

Background

Schluter is a family business, founded in 1858 and still owned and run by the family. I am now the 6th generation to run the business. Our vision statement is “To transform lives in Africa through commerce in a mutually profitable way”. I spent my early years in East Africa, and have always had a passion for development in Africa. I studied History and Economics and then Geography at Oxford with a focus on African development. On graduating, I joined the family business, and took over the management in 2003.

Scope of our Business

Within the commodity sector in which we operate, we are a small niche player. We work primarily in Ethiopia, Kenya, Tanzania, Burundi, Rwanda, D.R.Congo, Uganda and Cameroon. We have a presence on the ground in several of these countries. We are focused on adding value to the raw product to create a sustainable income stream for small farmers—many of whom rely on coffee as their only source of cash income. I come from the perspective that development is better done through trade than aid. We are representative of the SME sector, and of the challenges they face in raising finance. Most of our suppliers in Africa are in the same position, facing the same challenges in their internal markets.

Views on Development

I am a firm believer that sustainable development is best achieved by promoting income generation in developing countries. Whilst aid can and often does do a lot of good, it can also upset established markets in the commodity sector we operate in, and lead to market anomalies. For example, often well-meaning aid groups can come in and take a small quantity of coffee at a very high price, upsetting the entire local market, and leading to widespread losses as farmers then presume that all their coffee will go at similar prices and hold on to stock which then becomes old/stale and worth much less. Larger aid-backed projects are also well known for setting up alongside private enterprise, and with their overheads paid by grants and consequently lower overheads, they compete unfairly putting the private enterprises out of business. The aid-backed projects then frequently collapse themselves when the aid money is withdrawn or runs out. We have seen this many times in African coffee. This is not to say that some of them have not done some very good work.

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29 Eg, PIDG is technically a multilateral institution. When funds are repaid into its Trust, this does not affect DFID’s balance sheet or measurement of oda, unless funds are paid from the trust to DFID.
30 http://businessinnovationfacility.org/the-impact-programme
Coming from a smaller firm in the sector, access to finance is always an issue, and even more so for the small export companies we work with. They typically need working capital loans of between $10,000–100,000, whereas the available finance tends to be either microfinance of $10 to $100, or large grants of $1 million or above. If they are fortunate enough to obtain finance lines through local banks, they are typically at 18–24% p.a. interest, which removes much of their profitability. Many of the countries we work with depend very heavily on coffee as a source of foreign currency (in Burundi it is 80–90%). International pressure has recently led Burundi to auction off their internal coffee infrastructure, with the main buyers being multinationals, which in our opinion is very counter-productive. We believe that supporting locally owned export companies through partnerships allows the value added to remain “in-country” and builds prosperity in the local economy. However, the main barrier to this is access to finance, with proper understanding of futures markets and risk management being the other main barrier to local operators succeeding.

**What is needed most**

Hence, from our perspective, the greatest need is to make finance available to smaller companies to fill the gap between microfinance institutions and the larger loans, which are typically taken up by the multinationals. There are some institutions beginning to fill this space, but there is still a large gap. Equity investments, with some risk-sharing would also be very welcome. Typically the places most in need of development are also those with the highest risks. I am aware that management of finance is costly, hence the propensity to lend larger amounts, but perhaps funds could be used either to pay internal staff to manage a multitude of smaller projects, or to outsource this management with a reporting system which ensures that the finance fulfils the criteria set out for it. The finance available within this space currently carries a relatively high interest rate due to the costs of managing the loans. Lending in smaller tranches at reasonable interest rates could have a major impact on the local economies we are working with.

Although I studied development theory in my bachelor’s degree some 20 years ago, my experience remains quite narrow—within coffee and Africa, and thus questions which reflect this will obviously be easier to answer. August 2013

**Supplementary written evidence submitted by Schluter Ltd**

**The Case for Redirecting Aid**

British and other western governments seem to switch between giving towards “social service projects” to “direct government budget support” and back again. I would suggest the UK breaks out of this cycle by introducing new ways of donor support to poor countries.

Even if British money ends up in the right place, it can result in more government money being freed up for arms and military build up, thereby increasing the risk of conflict escalation.

If donor money no longer went towards supporting governments, whether directly in budget support or indirectly into health, water, sanitation or education projects, the governments would become fully accountable to the taxpayers, and the taxpayers would demand a greater degree of transparency. Thereby corruption and excessive military spending would be checked more effectively.

Therefore I believe good governance can come about by withdrawing aid rather than by giving more. An example of this is when Britain and others withheld money to Uganda over misappropriation of funds for Northern Uganda in the Office of the Prime Minister; as a result the government started to look for ways of being more efficient and the public began demanding accountability.

**Infrastructural Developments which could be Financed by Western Governments**

There are cases however where direct support towards infrastructural development would enable large scale projects to be built, which otherwise might not happen at all. The impact of these projects would be long term, and successive governments would be able to use them to develop their countries. They would become an engine for growth and the benefits would be felt by all sectors of the population. Some examples are listed below:

1. New standard gauge railway from Kigali via Kampala to Mombasa. This project has been agreed in principle by the Presidents of Kenya, Uganda and Rwanda, but will it get off the drawing board? If implemented it would enable Uganda to export food crops along with high value cash crops such as coffee, whereas at the moment the roads or railways cannot handle the volume.

2. New seaport in Lamu, Kenya and a railway connecting it to Southern Sudan. Again, this is agreed in principle, but could the right sort of support be given to make it happen?

3. Energy projects such as Karuma Falls in Uganda or the Inga Dam Hydro Electric Project in DRC, to supply power to much of central Africa and beyond, thereby reducing dependence on biomass for fuel.
4. Key roads such as the trans-Africa highway running through DR Congo, or rural roads connecting farmers to markets.
5. Commuter trains and road networks in congested cities across Africa. Too much expensive time is wasted sitting in traffic jams.

I do not think that these projects should be left to the Chinese alone but that Western Governments should also get involved, especially in the planning and project management side.

LEGAL SUPPORT TO THIRD WORLD JUDICIARIES
Western governments should reinforce the judiciaries in poor countries so that all sections of the population from big business to poor widows can have access to justice within a reasonable time frame. I have seen DFID work effectively in this area but a lot more needs to be done to change the culture for which a long term approach is required.

Laws governing land ownership and registration of land should be worked upon so that capital can be released using solid land titles as collateral. This would stimulate investment and provide jobs in both industry and agriculture. Land laws and property rights provided a solid foundation for building the USA but the same cannot be said for much of Africa, where injustice and endless property wrangles are the order of the day. DFID needs to build on what it has started or we could even see a regression in justice occurring.

AGRICULTURAL RESEARCH AND SEED SUPPLY
Most poor farmers do not have access to quality seed. Agricultural research should focus on improved genetic material and national bodies should take responsibility for its effective distribution to farmers. DFID and others should be involved in providing both expertise, management and funding. Development of disease resistant clones can take 10 to 15 years, and donors should get involved rather than focusing on three to four year projects which end up being unsustainable.

SUPPORT FOR SME’S WHICH ARE THE BACKBONE OF BUSINESS AND ECONOMIC GROWTH
I believe support for SME’s should be encouraged because their goal is survival, growth and sustainability. NGO’s on the other hand are into short term projects which often close down when the funding ceases. The British government seems to be lagging behind its European neighbours in supporting SME’s, preferring governments or NGO’s instead. Many SME’s have innovative ideas and sound business plans but are unable to access affordable credit because they don’t have bankable property titles. Donor support to SME’s can make all the difference in the early years when cash flow is critical for survival. Supporting small businesses is time consuming for the donor but I believe it is time and money well spent, because they provide a lot of employment, benefit other businesses, foster replication and have a wide development impact.

August 2013

Written evidence submitted by Adam Smith International

1. QUANTITY AND QUALITY OF UK AID SPENDING

1.1 The debate over the quantity of the aid budget seems largely to be coming to an end, now that the 0.7 target has been reached. It is natural that the debate will now move from the quantity of aid spending to its quality. This is a healthy shift.

1.2 0.7 represents a modest part of total UK public spending and the sum is not huge when compared to public needs in the developing world. In the form of simple resource transfer, UK aid will not make a huge difference to the lives of poor people in the developing world. This remains true whether it is 0.8%, 0.5% or 1% of GDP. Total public spending in India, just one country in receipt of UK aid funds, is some £70 billion, many times the total global UK aid budget.

1.3 It is only by using our aid resources in a transformative way that we have the ability to make a significant impact. UK aid needs to achieve the maximum leverage for every £1 spent. We can really only reduce poverty by helping transform the economies and societies of developing countries to achieve fast economic growth supported by effective governance. Of course there is an important role for humanitarian aid and on occasion other resource transfers. An effective development programme needs to use a variety of instruments. The main focus, however, should be on directing aid spending to the areas providing the best value for money and the highest return on investment.

1.4 This implies that it will be difficult to justify many straightforward resource transfers such as budget support, which is in any case difficult to track because of the absence of effective independent audit institutions in recipient countries. £1 of budget support buys £1 of public services (less transaction costs, waste etc). It is possible to have a much higher return on investment.
1.5 Care of course must be taken not to direct aid only into those programmes that are easy to measure. For example, improvements in governance are critical but more difficult to measure. The answer is to put more effort into measuring such programmes. Such measurement is a common feature of domestic spending initiatives in OECD countries, where return on investment for justice and security initiatives, for example, is frequently calculated.

2. **Development Finance**

2.1 We are not convinced that it is good policy to establish another development bank. There are already a considerable number of these bodies and we doubt whether another one is really needed. Indeed the BRIC countries are already committed to establishing a new development bank. Development banks tend to be slow and risk-averse, usually ending up lending lots of money to governments. As with any institution that lends other people’s money to other people, quality is often not very high. Process becomes the most important thing.

2.2 It would be worth considering more innovative solutions. For example one could encourage direct investment by UK citizens in private sector firms in developing countries. One option, put forward by Adam Smith International in a research paper for DFID, would be to encourage the creation of new institutions to enable private investors to invest in developing countries. We called these “Development Resource Trusts,” (DRTs). DRTs, dedicated to channelling private savings from the UK into the equity of companies in designated low-income countries, could help to overcome the equity gap in low income countries.

2.3 Tax incentives would encourage private investors to invest in these vehicles. They could be expected to result in a significant increase in interest on the part of ordinary investors in Britain in poorer developing countries.

2.4 Given the high levels of risk involved, tax incentives would have to be significant. They would have to be at least as generous as those pertaining to Venture Capital Trusts in the UK and likely more resemble those available for the Seed Enterprise Investment Scheme (50% income tax relief and no CGT on disposal). The cost of tax relief would be counted as official development assistance and would be attributed to the DFID budget. The cost of the tax relief would likely be less than the administrative costs of establishing and running a new development bank.

2.5 The use of a specific vehicle such as a DRT would enable DRT managers to offer investment expertise to retail investors. However another approach would be to provide the tax relief to any qualifying investment in a small company in the developing world. Entrepreneurs from those countries or their partners in Britain could then use crowd-sourcing techniques to raise funds. These are increasingly successful in attracting angel investors to domestic start-up projects in the UK and would be well-suited to raising investment for projects in the developing world.

3. **Multilateral aid**

3.1 The question is posed as to whether DFID has the right balance between bilateral and multilateral aid. In our view spending is currently weighted too heavily towards multilateral aid. As we describe below, multilateral organisations are relatively inefficient and not particularly accountable. It is difficult to identify clearly the results delivered by many of their programmes.

3.2 There is thus an increasing divergence between DFID’s bilateral programme, with its increasing emphasis on results, value for money, and accountability to the taxpayer, and DFID’s multilateral spending. We doubt that it is viable to have two distinct parts of the aid programme, a high-performing, accountable bilateral one and an inefficient, unaccountable multilateral one.

3.3 The playing field between multilateral and bilateral aid is not an even one. There are strong non-merit-based incentives to channel funds through multilateral organisations (eg avoiding in-house administrative costs and getting money out the door to meet budget targets). These incentives should be removed and the playing field made level so aid allocation decisions are made on a clear merit basis. Below we discuss the performance of various multilaterals and put forward suggestions for these policy changes.

**UN organisations**

3.4 Of all the multilateral organisations to which DFID gives funds, the UN ones are the most problematic. While the central UN political functions play a valuable role the same cannot be said of many of the various subsidiary organisations. Of these we are most familiar with one of the largest, the United Nations Development Programme (UNDP). We conducted an evaluation of UNDP’s work in Somalia, which had been financed by DFID and a variety of other donors. We found that while it seemed of poor quality and ineffective it was actually impossible to judge since due to the absence of information no coherent conclusions could be drawn as to results achieved.

3.5 As part of this evaluation we conducted an assessment of other UNDP projects in order to determine whether the problems were systemic. We looked at 30 evaluation reports. A very common feature was the full or partial inability to measure results. In most cases there was no clear baseline from which to measure progress,
reporting focuses on activities rather than outcomes and there are few if any measurable indicators. Other common features include:

- Complex bureaucratic procedures which cause extensive delays in implementing project activities.
- Poor and incomplete financial reporting with a lack of financial transparency.
- Poor project design, often over-ambitious with unclear objectives.
- Inefficiency and ineffectiveness in project implementation.

3.6 The evidence suggested that UNDP is focussed on resource mobilisation rather than the achievement of results. After discussion with DFID we looked at 16 further evaluations subsequent to May 2011, to determine whether improvements had taken place after the initial MAR exercise had been completed. They had not.

3.7 These conclusions are not surprising. Indeed they are echoed by analysis prepared for the UNDP’s own board. Take for example this conclusion of an internal evaluation of UNDP’s contribution to poverty reduction, considered by the UNDP Board a few months ago in February 2013 (our underline):

“The contribution of UNDP interventions to national poverty outcomes is seriously compromised by the absence of adequate support to learning from its interventions about what works and why. This in turn is caused in large part by the absence of a structure of incentives that would encourage systematic collection, monitoring and evaluation of evidence on the actual changes in people’s lives as a result of interventions. The fact that UNDP is nevertheless weak on learning stems from two main factors (as identified by numerous evaluations). First, quite often the results are defined in terms of inputs or outputs rather than final outcomes in terms of impact on poverty in its multiple dimensions. In consequence, not enough information is generated on the relevant outcomes that would help the office to learn what works and what does not for poverty reduction in particular contexts. Secondly, whatever information exists on results is not systematized and distilled into forms which others—both within and outside UNDP—can subsequently use for designing new and more effective programmes for poverty reduction. At the same time, the tendency of UNDP country programmes to spread themselves thin adds to the transaction costs that are inevitably associated with learning.”

3.8 It is difficult to understand in these circumstances why UNDP was rated “good” and “satisfactory” in DFID’s multilateral aid review and why it continues to receive large amounts of funds from DFID. One explanation is that the terms of reference for the review gave positive points to those agencies which were present in DFID’s priority countries, as UNDP undoubtedly is. But being present is far from the same as delivering results. Another explanation is that giving money to UNDP and other UN agencies involves much less hassle than putting it through a full competitive process and allows money to be spent quickly. There is also the “not being fired for buying IBM” factor, with UN being substituted for IBM. And since it is very difficult to establish whether anything is achieved or not, because of the poor impact measurement discussed above, the prospect of there being controversy about waste is pretty remote.

3.9 Another factor which explains the continued transfer of UK resources to UN agencies is the idea that this somehow helps “reform” them. In essence UN agencies are treated as if they are badly run developing countries in need of special assistance. They continue to be given funds in the expectation that they will reform, although they don’t. In fact it is a positive advantage for the UN agencies not to be able to measure their impact. It means that they can’t be held to account. The primary conclusion of our evaluation of UNDP’s work in support of governance and rule of law in Somalia was that it was not possible to tell the extent to which progress had been made towards outcomes. When we presented this conclusion to the UNDP Country Director he suggested that we should ask the donors to provide help to UNDP to get better at measuring impact. To be frank, such suggestions are at best misleading. UNDP is a huge global development agency with an annual budget of over $5 billion. If it can’t itself learn how to measure impact—scarcely rocket science—then it shouldn’t be in business at all.

3.10 UN agencies do not favour being subjected to competition. In Somalia a prominent UN representative recently stated that the UN should be exempt from the need to bid competitively, and that it should not be restricted from awarding resources non-competitively to other parts of the UN as the organisation was not tied to the normal definition of conflict of interest. In an earlier report on Nigeria, which criticised the poor performance of UNICEF, the Independent Commission on Aid Impact (ICAI) raised the question of whether DFID should contract UN organisations as implementers on a non-competitive basis. It is clear that the performance of these organisations is not so strong that they should be given major tasks on a non-competitive basis.

Multi-donor trust funds (MDTFs)

3.11 Multilateral organisations are frequently put in charge of MDTFs. Such funds are frequently set-up by donors in conflict-affected countries. Money can be disbursed quickly, even though it may not actually be used for any development purpose for several years. Funds sent to multilaterals are considered “spent” in accounting terms as soon as they are received by the multilateral. This means that DFID can quickly transfer funds to multilaterals to meet spending commitments.
3.12 However, the record of multilateral organisations such as UNDP and the World Bank in running such trust funds is poor. As a report on Evaluation of UNDP support to conflict-affected countries that was presented to the UNDP Board in January 2013 itself frankly commented:

"UNDP manages multi-donor trust funds in many conflict settings. The management of these funds has encountered some criticism with respect to high overhead charges, slow disbursement and the perceived preferential treatment given to the organisation’s own development support programmes."

3.13 As this report finding suggests, all too often the MDTF system is used to feed the UN itself as one of the highest priorities. UN agencies like to allocate resources to other UN agencies. Indeed they are expected to do so by the UN system. If we take the UNDP-run trust fund for Iraq as an example, the funds were first disbursed to UNDP. Then UNDP split up much of them between various UN agencies. Then the respective UN agency would often hire UNOPS (the UN Office of Project Services), to implement a project. Then UNOPS would often hire an international NGO, who would often hire a local NGO, who then would finally do something, which usually couldn’t be monitored and evaluated because it was too dangerous to do so. Of course each of the above bodies in the four-level chain would extract its management fee, adding greatly to unproductive costs.

3.14 World Bank-run MDTFs also suffer from similar problems. MDTFs are popular with the Bank, who look after some 500 of them, not least because they enable World Bank teams to supplement their administrative budgets. They are often subject to considerable procedural complexity and delay. The Sudan MDTFs are some of the most notorious examples of such delay, with funds not being spent for years, despite the urgent needs on the ground. ODI commented that “these World Bank-administered funds were supposed to ensure coordinated external donor support... In practice, they have failed to achieve visible impact. The rate of disbursement has been excruciatingly slow....Bureaucratic World Bank procedures, staffing problems and protracted negotiations on who does what hindered initial implementation.”

3.15 Research just published by DFID (Pooled Funding to Support Service Delivery : Lessons of Experience from Fragile and Conflict-Affected States, May 2013), while noting the theoretical arguments for MDTFs, casts some doubt on their practical application. It lists some of the disadvantages as follows:

— “Complexity: They often produce complicated implementation arrangements.
— Cost: Despite promising to cut costs, MDTFs are often more expensive in practice.
— Persistent front-loading: In some circumstances (particularly countries of high geo-strategic importance such as Iraq and Afghanistan) pressure to distribute funds quickly can lead to poor standards of implementation, weakening aid effectiveness and contravening state-building objectives.
— Slow disbursement: In other contexts, MDTFs can be slow to disburse funds in practice”.

The European Union

3.16 The UK funds a number of EU aid programmes, most of them compulsorily through the EU budget but one major one, the European Development Fund (EDF) relies on voluntary contributions from member states, including the UK. It is difficult to get to the bottom of whether these EU programmes perform effectively, as evaluation reports are not independent and are rather opaque in nature. It is notable that ICAI concluded in its review of “DFID’s Oversight of the EU’s Aid to Low-Income Countries”, “weaknesses in the EU’s own performance management and results framework make an overall view of the impact of EU programmes difficult to achieve.” ICAI further concluded that “DFID’s oversight does not provide the assurance needed, given the substantial scale of the UK’s contribution and the limited discretion the UK has about the EU as a route for aid”.

3.17 Some independent analyses of EU aid spending are carried out by the EU Court of Auditors and these are generally not very complementary. For example a recent report criticised the EU Commission’s expenditure of £6.1 billion on roads in sub-Saharan Africa because the Commission failed to ensure that recipient countries actually maintained the roads or enforced weight limits, leading many of them to fall into disrepair. In another report on “European Union development assistance for drinking water supply and basic sanitation in sub-Saharan countries” the Court of Auditors concluded that the majority of projects were unsustainable.

3.18 The EDF favours budget support as an aid modality. It is doubtful that the UK would provide budget support to many of the same countries, as the level of corruption and mismanagement of public finances there would likely provoke considerable public disquiet. Under the 10th EDF, 54% of budget support is targeted at nine countries (Mozambique, Tanzania, Burkina Faso, Ethiopia, Zambia, Madagascar, Niger, Mali and Ghana). Several of these countries are characterised by very high levels of corruption.

The World Bank

3.19 The World Bank was rated favourably in DFID’s Multilateral Aid Review and receives considerable funds from DFID. While the Bank indubitably has many technical staff of high quality there are very substantial problems with its modus operandi for the implementation and oversight of its programmes. There are often huge delays in its programmes, such that one has usually no real idea when they will start. To take one example, in 2008 DFID agreed with the World Bank to launch a joint programme in Nigeria called GEMS to help
remove barriers to economic growth. DFID was to fund and manage some components and the World Bank others. The DFID components started being implemented in 2009. The World Bank components have yet to start, five years later. It is possible that the DFID components will actually have finished before the World Bank ones start, if they ever do.

3.20 A key part of the problem is that the World Bank is set up as a bank. This places considerable restrictions on how it operates. A former senior World Bank official who has subsequendy worked with us has described the problem thus:

“Many of the Bank’s problems stem from its Human Resource issues. Staff personal incentives are not necessarily aligned with development effectiveness or efficiency. Bank staff are very concerned with their own job and justifying it….The Bank HR system does not incentivize risk taking and innovation in the lending operations, but does in the knowledge research area. There should be recognition of this—that although you can’t see the direct impact on the ground level as clearly, the knowledge part of the Bank is still very good and needed, but Bank management is over focused on the lending numbers”.

Monitoring the expenditure of multilateral institutions

3.21 The Committee is concerned as to how DFID can monitor and influence expenditure by multilateral institutions more effectively, especially in countries and regions where DFID does not have bilateral programmes. This is indeed a challenge, as highlighted in our analysis above. Even in countries where DFID has a presence, it can be quite difficult to find out what is going on. One solution is to require the respective multilaterals to be more open with programme information. However, nothing beats sending in an independent team to conduct a proper, detailed independent evaluation.

3.22 HMG should negotiate with multilateral organisations to which the UK provides funds on a voluntary basis to permit full access by ICAI to all programme information and financial data, in the same way that it has access to information about programmes directly funded by DFID. If after a period those multilateral organisations do not agree to provide this access then the UK should provide only core, compulsory funding.

3.23 The Development Select Committee should direct ICAI to undertake in-depth reviews of programmes conducted by multilateral organisations. Some of these should focus on countries and regions where DFID does not have a bilateral programme.

3.24 The UN is currently responsible for selecting and reporting to donors such portions of audits as the UN sees fit, often several years after the transfer of funds or the completion of activities. This means that difficulties in implementation or management are hard or impossible to spot and thus address. This is not helped by the rotation of donor staff who may be unable to correlate reporting with the justification for a project in the first place. The UN incorporates resources from programme funds to undertake evaluations of activities. These are not always routinely or widely shared outside of the UN or donors leaving the potential for a great deal of experience to be lost to the wider development community. Greater availability of internal and external reporting would also provide scrutiny that would drive accountability and allow strengths and weaknesses to be identified and addressed. DFID should make it a stipulation of funding that UN evaluations should be made fully and freely available in a timely manner to allow challenges to be addressed in an effective timeframe and to share relevant and up to date lesson learning with the wider development community. DFID should also stipulate that the UN system should publish full and as near to real-time audits of DFID funded programmes and make them publicly available.

Other suggested policy changes towards multilateral spending

3.25 The accounting treatment of funds given to multilaterals should be revised in order to remove one inappropriate incentive for funding them—in order to meet budget targets. DFID should change its accounting policy so that DFID money spent by multilaterals and trust funds is only counted as spent at the time when it is actually spent on the ground, not when it is transferred into the bank account of the multilateral.

3.26 It is not appropriate to fund multilaterals with high administration costs at a time when DFID’s own administration costs are being cut. The current system provides a perverse incentive for money to be spent on administrative costs, rather than less. The administrative costs of most multilaterals, as highlighted by the Committee in its recent DAR report, are way above those of DFID. The result is that DFID spends more on administration by funding multilaterals, the direct opposite of the original policy objective.

3.27 DFID’s administration costs should be redefined to include the proportionate administration costs of multilateral organisations to which it gives funds. Thus if DFID gave £1 million to a multilateral with administration costs of 7% then £70,000 should be added to DFID’s administration costs. At the same time the cap on DFID’s own administration costs should be lifted from the current 2% to some 3% or 3.5%. If there is a concern about adding to permanent civil service numbers then perhaps a cap on permanent civil service staff in DFID could remain, while the number of contract staff it can employ in administrative functions should be able to increase until the administrative costs cap is reached.
3.28 DFID should not retain multilateral organisations that directly implement, eg UNDP and UNICEF, on a non-competitive basis. They should always have to compete with others before being awarded work to carry out programmes.

June 2013

Written evidence submitted by the Center for Global Development (CGD)

**Summary**

- The Center for Global Development welcomes the opportunity to submit evidence about Development Impact Bonds (DIBs) as a new tool for effective development cooperation in the 21st century.
- The landscape for development cooperation is changing, requiring ways for traditional providers of development assistance to engage new actors and leverage private sector resources.
- DIBs are outcomes-based contracts in which private investors pay in advance for interventions needed to achieve agreed results, service delivery organisations work to deliver outcomes, and donors and/or governments make payments to investors only if the interventions succeed. The model allows each of these actors to make a distinct contribution to the achievement of social outcomes.
- DIBs are a new business model for the delivery of social services in developing countries: they transform neglected social problems into investible opportunities; introduce market rigour to achieving and measuring social outcomes; and build in more flexibility in service delivery than conventional publicly-funded programmes have, allowing for easier adaptation to beneficiaries’ needs and changing circumstances on the ground.
- Donors should consider testing DIBs in a range of areas. In assessing the costs and benefits in any particular case, donors should consider the value of transferring the risk of failure to the private sector.
- An expert Working Group convened by the Center for Global Development and Social Finance has produced a series of recommendations to encourage the development of a market for DIBs including that donor agencies should: establish a DIB Outcomes Fund; convene and participate in a DIB Community of Practice; and promote openness and transparency.

**Development Impact Bonds and the Changing Landscape for Development Cooperation**

1. The paradigm for development cooperation is changing. The world is no longer divided into rich countries giving aid, and poor countries receiving it. Most of the world’s poor live in countries now classified as middle income, and aid flows from new donors such as China and private philanthropy are increasing. The composition of external flows has also changed, with private investment and remittances now much more significant than aid. Meanwhile, an emerging class of social impact investors is seeking investments that yield both social and financial returns in developing country markets. Traditional aid donors are looking for ways to work with these new development actors, many of whom have little interest in the traditional aid model of grants from rich to poor countries.

2. As the context changes, so too does the role of aid. Aid still has an important role to play in supporting the provision of social programmes, but today traditional development agencies are challenged to determine how aid can be used to catalyse and complement the changing composition of financial flows to developing countries. Development cooperation for the 21st century requires new tools that facilitate partnerships between governments and private sector actors who have not just financial resources but skills and expertise to contribute to the achievement of development progress.

3. In this changing environment for development cooperation, Development Impact Bonds (DIBs) have enormous potential as an instrument which brings together the private sector, civil society organisations, governments and donors, in a way that captures and complements the best contributions of each player to achieve social outcomes. In a DIB, public, private and non-profit actors come together and agree on what they want to achieve and a method for measuring success. Typically, but not always, an intermediary organisation will play the role of coordinating these actors: investors, who provide funds to roll out or scale up services; service providers, who work to deliver outcomes; and outcome funders, public sector agencies from developing or donor countries who pay only for results achieved. Government agencies’ contributions to outcome payments are used to pay investors back, and with a premium if the program meets certain outcome benchmarks, so that if interventions successfully achieve outcomes, the returns are social as well as financial. This structure allows each player to make a distinct contribution to the achievement of a desired social outcome more effectively than if it were acting alone.
How do Development Impact Bonds work?

4. Development Impact Bonds are not merely a source of finance for development but a whole new business model for the delivery of social services in developing countries.

5. DIBs are an adaptation of Social Impact Bonds (SIBs), an approach pioneered in the UK, with promising experiments underway in America, Australia, Ireland and other countries, designed to provide effective and cost-efficient solutions to social problems through programmes that are more flexible than conventional publicly funded programmes. The first SIB, launched in the UK by the intermediary Social Finance, was designed to reduce recidivism: private investors cover the costs of a range of individually targeted services aimed at preventing reoffending, and are remunerated, with a return, only if evidence shows that those services were successful in bringing down reoffending rates. The UK Ministry of Justice pays returns to investors from the cost savings that result from lower reoffending.

6. Although it is too early to draw conclusions about the success of any SIBs, the Ministry of Justice has released preliminary data that shows that for the target population of this first SIB pilot—ex-offenders from Peterborough Prison—reoffending has gone down by 6%, compared to a national increase of 16%. These early numbers and the anecdotal evidence thus far suggest that service delivery is working well under the Peterborough Prison SIB. Because investor returns are aligned with a social outcome, all actors within the SIB have an incentive to focus on that outcome. This is a change compared to a conventional service delivery model that is based on the tracking of pre-specified inputs and processes. Because under an outcomes-based model public sector agencies are not providing the working capital, programmes have more flexibility, enabling them to adapt to beneficiaries’ needs and changing circumstances on the ground. In the Peterborough Prison SIB, private sector actors are using rigorous performance data to ensure that individual client needs are being met, and are adapting and improving the service delivery model as the programme progresses.

7. An expert Working Group convened by the Center for Global Development and Social Finance explored how the Social Impact Bond model can be applied to developing countries and quickly found that many of the same challenges in public sector service delivery that apply in industrialized countries apply in development as well: social programmes are not adequately focused on achieving and generating clear evidence of outcomes; they are rigidly designed, limiting the learning and adaptation that can take place throughout the processes of delivering services to individuals with often complex needs; and they do not invest adequately in prevention, which often is much less costly than dealing with the treatment of a problem at a later stage.

8. A Development Impact Bond puts in place a business model to deal with these challenges for conventional public sector programmes. The distinguishing feature of a DIB is that because programmes will not typically generate immediate cashable savings, external development agencies would normally be needed to provide the outcome payment, or some portion of it in partnership with a developing country government, paid only if the results are achieved. DIBs are therefore a tool which can improve both the effectiveness of public services in developing countries and the efficiency of donor spending.
9. By having private investors provide, and assume risk for, funding for social programmes and by tying returns to the achievement of social outcomes, DIBs are a groundbreaking approach to development programmes:

(a) **DIBs transform neglected social problems into investible opportunities:** By using concessional public money to put a value on the achievement of social outcomes, DIBs transform seemingly intractable social problems—often involving ensuring access to services for society’s most poor, vulnerable and hard to reach—into “investible” opportunities for investors, who otherwise would not have the incentives to be involved in social service delivery. This widens the opportunities available for investors looking for decent returns but also concerned about social impact.

(b) **DIBs introduce market rigour to achieving social outcomes:** Because investors’ returns are tied to the achievement of social outcomes—and because the size of the returns are commensurate with the level of success (i.e. the higher the social gains, the higher the returns)—investors are given incentives to target populations that face the greatest needs, as this is often where the greatest gains (social and financial) are to be had. They are also given incentives to deliver those services in the most efficient and cost-effective way, and put in place the necessary feedback loops or performance management to create bottom-up, client-centred approaches.

What should donors’ role be?

10. Under a DIB, it is the role of public sector agencies—typically a donor agency like DFID—to work with Government and other partners to identify the outcomes that society values and ensure that rigorous measurements are taken to determine whether those outcomes have been achieved, and to build an understanding and evidence base of what works under what circumstances in service delivery.

11. DIBs depend on donor agencies being willing and able to provide private sector actors with appropriate risk-adjusted returns. If programmes are not successful in achieving the desired outcomes, DIBs have the benefit of costing taxpayers nothing, as the donor pays only for results. If programmes are successful, they will involve a cost to the taxpayer that is greater than the direct cost of the inputs of the successful programmes, in order to cover a modest return for investors, which helps compensate for the risk of losing their capital. Though successful programmes will appear more expensive for the taxpayer, this is offset by the elimination of payments for unsuccessful programmes. Donors will have to conduct a cost-benefit analysis for the business case of any proposed DIBs, but in doing so should consider the value of transferring the risk of failure to the private sector, and the comparison of total costs entailed in a DIB with both successful and unsuccessful projects under alternative approaches.

12. Donors should consider DIB cases in a range of sectors and contribute to the development community’s rigorous testing of this new approach. It is expected that a market for DIBs will gradually emerge as the approach is piloted and lessons are shared.

13. DFID could be a leader in progressing the recommendations of the DIB Working Group for donor agencies, including:

(a) **Collaborate to establish a DIB Outcomes Fund** to pool risk for initial DIB projects with other donors and to more easily share lessons learned.

(b) **Convene and participate in a DIB Community of Practice** of donors, investors, intermediaries, government agencies from developing countries and larger service provider organisations, to ensure that learning is shared, disseminated, and applied to future programmes.

(c) **Promote openness and transparency** to reduce transactions costs over time and help build an evidence base for DIBs: donor agencies should require that outcomes data be made public, and contracts also be published.

June 2013

**Written evidence submitted by the Bretton Woods Project**

**Summary**

1. The Bretton Woods Project is an independent non-governmental organisation (NGO) established by a network of UK-based NGOs in 1995 to take forward their work of monitoring and advocating for change at the World Bank and IMF. See www.brettonwoodsproject.org/about for more details.

2. We welcome the decision of the International Development Committee (IDC) to undertake this inquiry. Our comments focus on the World Bank. At present, the World Bank is the largest multilateral recipient of UK aid, with the UK having become the largest International Development Association (IDA, the Bank’s low-income arm) donor at the last replenishment, and the Bank also being the recipient of a significant amount of additional UK funding.

3. **The role of the UK as a provider of climate finance:** The UK is channelling large volumes of its climate finance through the World Bank Group despite the lack of country ownership and failure to identify and reach
those most in need. The projects have also been of variable quality and have been accused of furthering development bank agendas rather than piloting new innovative approaches. The UK should redirect climate finance to support the Green Climate Fund and other UN initiatives, such as the Adaptation Fund, while limiting the World Bank’s role in climate finance, including in the Green Climate Fund.

4. The right balance between bilateral and multilateral aid: The World Bank’s poor track record, excessive focus on large-scale infrastructure, and insufficient attention to the impacts of its projects on climate change and land tenure are evidence that it is not the most effective means for channeling aid spending. The increasing concentration on lending to the private sector has unproven development outcomes and the investment in the financial sector is both risky and further obscures results. DFID should not increase contributions to the World Bank Group with its increased aid budget absent substantial reforms in key areas.

5. Monitoring and influencing the World Bank Group. The UK needs to consider the needs and concerns of developing country governments and people affected by World Bank activities. It can work towards strengthening accountability mechanisms and independent evaluation as well as enhancing transparency of its own interaction with the Bank and addressing the legitimacy problem that comes with the Bank’s insufficiently reformed governance structure.

A: Effectiveness of the channelling climate finance through the World Bank Group

6. The UK has committed £2.9 billion to international climate finance until 2015 through the International Climate Fund, including £1.5 billion in fast start finance from 2010–12. As of May 2013 the UK had provided over £1 billion to the World Bank–housed Climate Investment Funds (CIFs), including £813 million in fast start finance, making the UK its biggest donor. The UK is also supporting other Bank initiatives, including £130 million (£51 million in fast start finance) to the Climate Public Private Partnership (CP3), £10 million in fast start finance to the Bank–housed Forest Carbon Partnership Facility (FCPF) and £7 million in fast start finance to the Bank–led Partnership for Market Readiness (PMR).31

7. The CIFs have been criticised from their inception, including concerns about their governance structures (including the role of the World Bank) and lack of legitimacy because of their distance from the official UN Framework Convention on Climate Change (UNFCCC) process. Furthermore, the Bank’s role as both trustee and implementer is deemed controversial.32 These critiques have been strengthened as the new UNFCCC Green Climate Fund is being operationalised, meaning the CIFs are supposed to “sunset”. However, few concrete actions have so far been taken to activate this sunset clause.33 The UK has so far declined to pledge financial support for the Green Climate Fund, despite the critical importance of donor funding to ensure its viability. In its engagement with the Green Climate Fund, the UK has primarily focused on the development of the private sector facility, despite limited evidence of the ability of the private sector to play a strong role in climate change adaptation. An increased push for the private sector is also seen in the CIFs, including an increased role for the International Finance Corporation (IFC, the Bank’s private sector arm).

8. Other criticism of the CIFs includes lack of country ownership and failure to identify and reach those most in need. The projects have also been deemed of variable quality and have been accused of furthering multilateral development bank (MDB) agendas rather than piloting new innovative approaches. The CIF Clean Technology Fund (CTF) has received severe criticism from CSOs for supporting large scale projects, designed for electricity export rather than for energy access for local populations. There is evidence that the Pilot Program for Climate Resilience (PPCR, one of the CIFs) has been MDB driven, with weak structures for participation of local communities. The Forest Investment Program (FIP, another of the CIFs) has been rejected by local communities and indigenous peoples in many countries, including because of its impacts on intact forests and links to commercial logging. The Scaling Up Renewable Energy Program in Low income Countries (SREP, another CIF) is less advanced, but has already been criticised for not prioritising poor countries. Furthermore, the results frameworks for the respective CIFs as well as gender aspects require further work.34

9. The UK published its annual internal evaluation of the CIFs in July 2012. The evaluation noted some problems, such as “there remains limited information on the expected results” on FIP. Other challenges noted include “slow speed of disbursement and project approval” and “variable quality of some investment plans and projects”. It also noted that “lack of clarity over future of CIFs and implications for the potential funding gap should the GCF not be up and running quickly” remains. Key government recommendations included to keep pushing for the results framework to be finalised “to enable this improved monitoring of results” and to “push for a risk management framework”. Furthermore, it noted that “while good progress has been made on the measures to improve the CIFs, we should continue to watch implementation, for example on gender and development, and transparency.”35

32 See A faulty model? What the Green Climate Fund can learn from the Climate Investment Funds http://www.brettonwoodsproject.org/art-568688
33 See various editions of the CIFs Monitor http://www.brettonwoodsproject.org/cifs/index.shtml and A faulty model? What the Green Climate Fund can learn from the Climate Investment Funds
34 See various editions of the CIFs Monitor http://www.brettonwoodsproject.org/cifs/index.shtml
35 See Climate Investment Funds Monitor 6, 26 October 2012 http://www.brettonwoodsproject.org/art-571458
10. The CP3 is implemented in collaboration with the Asian Development Bank and an IFC private equity fund. While only in inception stage it has already attracted criticism for its focus on middle-income countries, lack of transparency and accountability, and lack of focus on energy access.36

11. The World Bank push for carbon market initiatives, including the PMR and FCPF, has also been criticised, in particular given flagging carbon markets and due to the possible negative impact on indigenous peoples.37

12. **Key recommendations:**

- DFID should ensure climate finance is governed by sustainable and equitable principles including: a participatory approach; in support of renewable technology; pro-poor focus; through a democratic institution; under UN supremacy; and using grants, not loans.
- DFID should redirect climate finance to support the Green Climate Fund and other UN initiatives, such as the Adaptation Fund, while limiting the World Bank’s role in climate finance, including in the Green Climate Fund.

B: Balancing bilateral and multilateral aid—Effectiveness of the World Bank Group

13. In many critical areas the World Bank’s performance has been poor. An annual Independent Evaluation Group (IEG) report on the Results and performance of the World Bank Group 2012, released in December 2012, showed declining effectiveness, with the Bank’s worst ratings in areas with the fastest increases in lending or extra priority, such as infrastructure and public-private partnerships (PPPs). The report from the IEG, the Bank’s arms-length evaluation body, covered projects closed before end June 2012 and looked across the entire World Bank Group. Good ratings on investment loans fell from 78% for 2006-08 to 70% in 2009-11. “Along the projects that exited the active portfolio in FY09-11, 26% were rated either satisfactory or highly satisfactory, and 44% were rated moderately satisfactory”, showing that even the positive ratings are driven predominantly by mediocre results.38

14. According to the IEG report, particularly problematic were investment loans for infrastructure and to projects in the East Asia and Pacific region, both of which saw statistically significant drops in good ratings for 2009-11. In its analysis of why things were going badly in infrastructure, agriculture, and beyond, the IEG found “overambitious project design, inadequate consultation with stakeholders, insufficient candour during supervision, and failure to follow up on problems identified during supervision missions as reasons for less-than-satisfactory achievements.” However, infrastructure, and particularly large cross-border projects is an area where the Bank is planning an expansion of its work39 despite past practice showing that this is an area ripe with corruption possibilities, overspending and under-delivering on results. While no one doubts that there is an under investment in infrastructure in most developing countries, the renewed focus on mega projects rather than pro-poor infrastructure, such as rural roads or low-carbon off-grid energy, is a worrying trend.

15. The World Bank Group maintains an ineffective set of staff incentives which do not effectively prioritise value for money, development effectiveness or sustainability. While Bank staff are expected to consider development effectiveness, gender, and a suite of safeguards, their internal incentives prioritise meeting volume targets on their lending.39 Volume targets are not a good indicator of value for money or development effectiveness and in fact may encourage poor value as staff harden targets at the end of the year with lower standards applied to projects.

16. The World Bank has a poor track record when it comes to the management of environmental and social impacts of its projects. Though the World Bank introduced environmental criteria into its operations in 1987 and began disclosing environmental impact assessments in the early 1990s, a plethora of projects still proceed without adequate attention to environmental or social concerns. Additionally, the World Bank still invests heavily in fossil fuel projects, creating negative impacts in relation to climate change. In essence it is subsidising carbon-intensive energy projects at the same time that the G20 has been endeavouring to eliminate heavily in fossil fuel projects, creating negative impacts in relation to climate change. In essence it is subsidising carbon-intensive energy projects at the same time that the G20 has been endeavouring to eliminate

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36 See “False Solutions? The IFC, private equity and climate finance” Bretton Woods Project, Bretton Woods Update No. 80, 5 April 2012 http://www.brettonwoodsproject.org/art-569966


17. Accountability for failing to uphold World Bank standards is also lacking. In fiscal year 2012, five projects had inspection requests filed with the Inspection Panel, the Bank’s compliance arm, with a further three cases filed in FY 2013. In one of these cases, relating to the Vishnugad Pipalkoti dam project in Northern India, Bank staff in India publicly repudiated any accountability by pre-empting Inspection Panel findings with public statements that the project would go ahead regardless of any findings of the Panel. This highlights a problem with the Panel’s mandate, unlike a true judicial accountability mechanism, it is not able to force Bank management to make amendments for harm caused by projects.

18. The Bank has recently faced vociferous criticism for its impact on land tenure and land rights, particularly of poor or marginalised communities. The Bank has been accused of aiding and abetting land grabs in many countries, including through a forest project in Uganda, a palm oil project in Uganda, rubber plantations in Cambodia/Lao, a commercial real estate project in Cambodia, and through foreign farm land acquisitions across Africa and Latin America. The Bank’s work on the principles for Responsible Agricultural Investment has been consistently rejected by groups representing small farmers. While in April this year the World Bank president has accepted the need to work instead with the UN-organised Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security, no action has yet been taken on this front.

19. The World Bank finally launched an expected review of its environmental and social safeguard policies in October 2012. Whilst the Bank committed to a robust outcome, civil society organisations have highlighted concerns that the emerging framework will replace existing safeguards with vague principles and non-mandatory “flexible” implementation standards. Furthermore, the review only covers investment lending, but not other instruments, such as development policy lending and Program-for-Results. Bank management has therefore still not highlighted the implementation failures related to existing safeguards or the gaps in coverage, but instead the time it takes for projects to navigate the project cycle, leading to worries about dilution of the already inadequate system. For example, the Bank safeguards do not include a requirement for “free, prior and informed consent” of indigenous peoples as spelled out in the UN Declaration on the Rights of Indigenous People, which the UK has endorsed.

20. In a number of significant ways, the Bank’s approach does not support country-led development. The Bank has somewhat reduced the use of policy conditionality, but a 2012 internal World Bank review of one of their policy lending instruments (development policy loans or DPLs) developing countries reported that the use of prior actions has “remained at 10 per operation”. The concerns over the use of “one size fits all” conditionalities remain, restricting the pursuit of democratically chosen policies appropriate to national contexts. In the review, the Bank themselves rated only 17% of prior actions as having positive social and environmental effects.

21. The Country Policy and Institutional Assessments that largely determine allocations to IDA countries have also been heavily criticised by developing country governments, the IEG and civil society for not

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Footnotes:
41 For more details on this case please see “Getting its hands dirty: World Bank increases fossil fuel lending”, Bretton Woods Project, Bretton Woods Update No. 84, 12 February 2013.
45 A May report from NGO Global Witness, Rubber Barons, details allegations of land grabbing by IFC-funded Vietnamese rubber companies operating illegally in Cambodia and Lao. See http://www.globalwitness.org/rubberbarons.
52 For a further discussion of gaps in coverage and recommended enhancements to the safeguards, please see “Safeguards: World Bank urged to incorporate human rights commitments “in all of its activities”, Bretton Woods Project, Bretton Woods Update No. 85, 8 April 2013, http://www.brettonwoodsproject.org/art-572246.
53 http://go.worldbank.org/3M7EPD0GB0
effectively reflecting country ownership, need and effectiveness. While the Bank has increasingly recognised that the aid allocation formulas are problematic, they have moved to amend them in this year’s IDA replenishment only for countries that are considered fragile or conflict-affected.

22. The World Bank is increasingly relying on group-wide strategies and the involvement of the private sector to deliver development results. However there is little evidence of the ability of the private sector to deliver development results. A systematic review of private participation in infrastructure, which looked specifically at a DFID and IFC supported facility, found that “hard evidence is scarce” and that “it is difficult to measure causal relationships between infrastructure provision and development outcomes.” It found that it was “very difficult for [development finance institutions] to achieve enhanced direct poverty effects using purely commercial finance”, which is the claimed modus operandi of the IFC, and the number of projects that this could be achieved on was strictly limited.

23. On top of this the IFC is increasingly using financial intermediaries, meaning third-party financial entities such as banks, insurance companies, leasing companies, microfinance institutions, and private equity funds. In early February the IFC’s accountability mechanism, the Compliance Advisor/Ombudsman (CAO), released an audit report that found that for this growing part of the IFC’s portfolio, now over 40% of the total, the IFC conducts “no assessment of whether the [environmental and social] requirements are successful in doing no harm.” The CAO indicated that “The result of this lack of systematic measurement tools is that IFC knows very little about potential environmental or social impacts of its [financial market] lending.” The same lack of knowledge also applies to the development impacts of the financial sector lending. Despite pressure from civil society and the CAO, the IFC has refused to recognise that there is a problem with their systems for measuring results or risks from sub-clients of the IFC’s financial sector clients.

24. World Bank President Jim Yong Kim took over at the World Bank in mid 2012 and wants to reshape the Bank according to his own strategic vision. This strategic change and restructure will set the future direction for the Bank, but is as of yet incomplete. It would be premature for the UK to commit to increasing funding for the Bank and its concessional grants arm, given the uncertainty over the strategic directions of the Bank. They may improve the effectiveness of the Bank, or they may take it in the wrong direction.

25. Evidence so far on the new strategy has not been encouraging. Dr. Kim set two overarching goals for the Bank without effective external consultation with stakeholders. These goals have been set despite there being a robust global debate, in which the UK Prime Minister is closely involved, in what should come after the Millennium Development Goals. Dr. Kim’s speeches have reiterated emphasis on growth and very large-scale infrastructure without sufficient attention to inequality, participation of affected people, for the Bank and engage with both policy and projects would also enhance effectiveness of the institution. This would especially be the case in countries where DFID does not have programmes. The Bank’s Global Program for Inspecting, Monitoring and influencing the World Bank Group

27. The World Bank Group should take remedial measures in a number of areas, which can be facilitated by shareholder monitoring and influencing. Unfortunately the multilateral aid review focussed predominantly on bilateral UK priorities with little developing country input and ownership. Care should be taken that the UK does not dictate agendas to the Bank that are not in line with either developing country government wishes or the concerns of poor people affected by the World Bank’s activities.

28. At the World Bank there is insufficient use of independent assessment and no requirement for action in response to critical evaluations. This is true for both the IEG and the accountability mechanisms such as the Inspection Panel and the CAO. One of the most effective mechanisms for improvement at the Bank would be to strengthen the independent evaluation and accountability mechanisms with greater independence and requirements for Bank action in response to findings of shortcomings in Bank policy and practice.

29. Ensuring that civil society organisations can effectively participate in decisions making processes at the Bank and engage with both policy and projects would also enhance effectiveness of the institution. This would be the case in countries where DFID does not have programmes. The Bank’s Global Program for

54 See this article for more detail: "IEG calls for overhaul of World Bank’s lending criteria", Bretton Woods Project, Bretton Woods Update No. 69, 15 February 2010, http://www.brettonwoodsproject.org/art-565918.


56 For more detail on this issue please see: "IFC oblivious to impact of lending to financial sector", Bretton Woods Project, Bretton Woods Update No. 84, 12 February 2013, http://www.brettonwoodsproject.org/art-572062.

The long term relevance of the 0.7% ODA target

1. The 0.7% target was first agreed under the auspices of the UN in 1970. It has never been a strongly evidenced target, more a political tool, which implies that discussions about changing it will be at least as much political in nature as technical. A range of factors imply that the current definition and target of ODA are no longer fit for purpose.

2. Studies suggest that extreme poverty is continuing to decline rapidly, although there is continued discussion about the likely future “geography of poverty” (Sumner 2010, Kharas and Rogerson 2012).

3. Most developing countries are increasingly moving away from reliance on aid, even in Africa (Actionaid 2012, Glennie 2008), which raises questions over whether there will still be demand for traditional aid in the future.

4. Amongst the broader goals (beyond poverty reduction) that future ODA could help to mobilise finance for the provision of are addressing climate change and environmental sustainability, global health challenges and security—often grouped under the heading Global Public Goods (GPGs) (Severino 2009, ODI forthcoming). The implications of a more ambitious agenda addressing GPGs alongside poverty reduction might be the need for more resources overall, and the need to focus even on countries where extreme poverty is no longer prevalent.

5. The growing volume of development assistance coming from Southern donors and new development cooperation actors is a crucial additional factor. ODI estimates that these flows were equivalent to at least 30% of OECD donor contributions in 2011 and are growing fast (Greenhill et al. 2013). ODI’s Claire Leigh and Jonathan Glennie have proposed that all countries, even the poorest, might contribute something to global development financing in the future (Leigh and Glennie 2013).

6. This discussion began some time before the process of agreeing development goals to succeed the MDGs and a package of measures to pursue them (for example see Severino 2009), but has been given added impetus by this process.

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1.7 There appear to be two broad scenarios. Either aid gradually declines as poverty is reduced globally and countries rely more on non-concessional flows. Or aid continues to be of importance, as objectives multiply and the unique character of public finance at a global level is considered important. In the former scenario, the 0.7% target would seem too high; in the latter it may not be sufficient.


Written evidence submitted by the Overseas Development Institute

1. The long term relevance of the 0.7% ODA target

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1.3 Most developing countries are increasingly moving away from reliance on aid, even in Africa (Actionaid 2012, Glennie 2008), which raises questions over whether there will still be demand for traditional aid in the future.

1.4 Amongst the broader goals (beyond poverty reduction) that future ODA could help to mobilise finance for the provision of are addressing climate change and environmental sustainability, global health challenges and security—often grouped under the heading Global Public Goods (GPGs) (Severino 2009, ODI forthcoming). The implications of a more ambitious agenda addressing GPGs alongside poverty reduction might be the need for more resources overall, and the need to focus even on countries where extreme poverty is no longer prevalent.

1.5 The growing volume of development assistance coming from Southern donors and new development cooperation actors is a crucial additional factor. ODI estimates that these flows were equivalent to at least 30% of OECD donor contributions in 2011 and are growing fast (Greenhill et al. 2013). ODI's Claire Leigh and Jonathan Glennie have proposed that all countries, even the poorest, might contribute something to global development financing in the future (Leigh and Glennie 2013).

1.6 This discussion began some time before the process of agreeing development goals to succeed the MDGs and a package of measures to pursue them (for example see Severino 2009), but has been given added impetus by this process.

1.7 There appear to be two broad scenarios. Either aid gradually declines as poverty is reduced globally and countries rely more on non-concessional flows. Or aid continues to be of importance, as objectives multiply and the unique character of public finance at a global level is considered important. In the former scenario, the 0.7% target would seem too high; in the latter it may not be sufficient.
2. The suitability of DFID’s mix of financial instruments, including its use of loans and traditional grant aid

2.1 DFID does not currently deliver any of its ODA in the form of loans, although its grant contributions to a number of multilateral institutions are lent on to developing countries. However, the share of loans in total ODA has been on a gradually increasing trend since 2007 and reached just over 20% in 2011 (Tew 2013).

2.2 There are a number of arguments commonly put forward in favour of providing ODA in the form loans rather than grants, including their ability to mobilise large levels of upfront resources for countries (an effect which is neutralised over the length of the loan due to repayments) and possible disciplining effects on the use of resource use by recipients (which is disputed in the literature) (Tew 2013).

2.3 The major downside to ODA loans is that they have to be repaid and therefore require developing countries to divert resources away from public spending towards such repayments. This issue retains major relevance in many developing countries, as debt levels have increased since the global economic crisis. Aid levels stagnated during this period and developing countries have had to rely on loans for around 40% of the resources they have raised to compensate for the falls in revenue (DFI and Oxfam 2013).

2.4 These characteristics of loans suggest that grants are more suitable for countries with lower levels of income, higher levels of inherited debt, higher risk of economic volatility and limited fiscal capacity (Baudinville et al 2009). Although countries with these characteristics tend to be those in the low income category, it would also be the case for many MICs, given the breadth of the middle income country (MIC) category (which covers countries with annual incomes between $1,026 and $12,475). Country classifications are now, in fact, a questionable tool for making such financing decisions (Glennie 2011).

2.5 Much of the impact of loans on the resources of developing countries will depend on the terms of the loan being provided. There are a range of ways in which donors can lessen this impact and ensure a loan is concessional, including charging below market interest rates, providing lengthy repayment periods and blending loans with grants. It is vital that donors use such approaches to tailor loans to country needs and challenges.

2.6 These conclusions point to the need for DFID to address any question on the use of loans and their concessional on the basis of the portfolio of countries it wishes to provide assistance to and robust assessments of their economic and financial capacity to manage loans.

2.7 The characteristics of loans also point towards there being a stronger case for grants to fund projects that do not generate revenues (like private sector and infrastructure investments) and involve higher risks (Baudinville et al). As a result DFID’s policy on loans may also need to be informed by decisions on the mix of such activities in its portfolio.

3. Role of the UK as a provider of climate finance

3.1 The UK’s climate finance contribution is of vital importance to helping developing countries incorporate climate change into their development strategies. The UK has played a critical leadership role in global efforts to mobilise funding to this end, consistent with commitments made under the UN Framework Convention on Climate Change to scale up climate finance in the context of securing ambitious global collective action on climate change (Nakhooda et al 2012). It is crucially important for the UK to continue to deliver climate finance in support of these commitments, and to continue to make progress on options for scaling up the level of support that it is delivering, while continuing to strengthen the effectiveness of the support that it delivers.

3.2 There is substantial interest in how climate finance can be used to enable fundamental transitions to climate compatible development in developing countries. There is particularly interest in the role that climate finance can play in mobilizing private sector investment in low carbon and climate resilient approaches (Whitley 2012). There is an important role for public climate finance in supporting public sector institutions to explore and implement necessary changes and improvements to underlying policies and regulatory frameworks that will make climate compatible development more viable (Nakhooda 2013). Such support may be usefully delivered through grants that support the budgets of key institutions and capacity building initiatives. There may also an important role for grants in supporting research and engagement with non-governmental institutions within countries that can support and inform more ambitious and effective action on climate change within developing countries (Whitley 2011, Nakhooda 2013).

3.3 Different interventions to support climate change entail different costs, risks, and different actors can play different roles. There is a strong case to be made for tailoring instruments to the particular risks and needs that a climate related intervention entails (Nakhooda 2013). By mobilising climate finance contributions as grants and capital grants, implementing agencies can use this funding in a discretionary way to address these risks in a tailored fashion. We observe that the decisions of some countries to capitalize multilateral climate funds such as the Clean Technology Fund with low cost loans has in some cases significantly constrained the risks that the fund is able to bear (for example, in some cases the risks associated with local currency lending for clean energy projects in developing countries were seen as too high for the loan capitalization to bear). There is a need to continue to ensure that climate finance can be used to bear a diversity of risks and costs, and to allow flexible and innovative approaches to program design.
4. Whether the UK should establish a new, independent development finance institution to offer concessional loans?

4.1 Development finance institutions (DFIs) play an important role in the international cooperation system through their provision of support to the private sector, catalysing private investment, providing counter cyclical funding during economic crises and delivering technical assistance (te Velde 2011). In providing this type of support DFIs have been found to contribute to increases in foreign direct investment (te Velde and Warner 2007), productivity, employment and economic growth (Jouanjean and te Velde 2013).

4.2 The establishment of a new independent UK development finance institution to offer concessional loans would be a major undertaking by the UK Government, and it is therefore vital that a number of important questions are addressed before such a decision is made.

4.3 Firstly, it will be important that any decision is informed by an assessment of the financing needs of the UK’s development partners and how/whether such an institution will address these needs. As highlighted in section 2 this should in part be based on assessing the degree to which these partners require and are in a position to manage the financial consequences of loans. This should also involve understanding the degree to which its partners require the types of financing tools that DFIs commonly provide, including loans, guarantees and equity investments.

4.4 Assuming that the UK’s development partners would benefit from greater access to the type of support provided by DFIs it will be important to establish what the value added of establishing such an institution will be in comparison to other bodies—both in the UK and beyond—that are currently operating in this space, including multilateral agencies, development finance institutions and private sector actors. If these actors are better equipped to respond to these challenges and are motivated to and likely to be successful in scaling-up their efforts then channelling support through them would likely be preferable.

5. DFID’s balance between provision of bilateral and multilateral aid?

5.1 DFID’s Multilateral and Bilateral Aid Reviews have made an important contribution to the UK Government’s (and broader donor) efforts to assess the performance of these aid delivery channels and to inform decisions allocating aid across them. However, IDC will be well aware of the results of these reviews, so this section of our submission will focus on highlighting some additional insights relevant to questions, especially on the relative performance of multilateral aid agencies.

5.2 There has rightly been increasing attention on the administration costs of the various multilateral agencies, but it is important to recognise that the cost effectiveness of these organisations goes beyond this relatively narrow element. Multilateral agencies have some inherent characteristics that contribute to promoting cost effectiveness. These include reducing the aid management burdens for recipients by coordinating support from a number of donors, their delivery of untied aid and their potential to achieve economies of scale in managing aid programmes.

5.3 There have been a number of attempts beyond the MAR to assess the effectiveness of multilateral aid agencies, including ones that judge them relative to bilateral agencies. These suggest that multilateral aid agencies perform at least as well as bilateral aid agencies in relation to the Paris Declaration on Aid Effectiveness principles and commitments (OECD 2011) and may well be outperforming bilateral agencies in relation to an even broader set of criteria (Easterly and Pfrutze 2008, CGD 2011).

5.4 In relation to the value added of regional development banks an important aspect of their functioning revealed by a 2007 survey by ODI was a perception by recipient countries that their closer role in the governance of these agencies has helped to shape their greater sense of ownership of their programmes (Burrall 2007).

5.5 Recent research by ODI has also illustrated how developing countries value the speed of response and delivery of some emerging donors (Greenhill et al 2013), which highlights the need for multilateral agencies to address obstacles to delivering their assistance more rapidly.

5.6 Finally, an element of the value added of multilateral agencies that is becoming more prominent and may give them renewed significance in the coming years is that relating to their response to GPGs. A addressing needs relating to GPGs benefits from the ability of multilateral agencies to pool contributions from a large range of actors in support of a coordinated response to development challenges (ODI forthcoming). Multilateral agencies are already playing such a role in relation to climate change, where bodies such as the Climate Investment Funds are leading global efforts to support country efforts to adapt and mitigate the effects of climate change.

5.7 It is important that future assessments of the performance of multilateral agencies that feed into aid allocation decisions take into account all relevant factors, including their evolving role in the international cooperation system.
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June 2013