

Civil society organisations' position on Private Sector Instruments October 2018

This position has been prepared by a coalition of civil society organisations from the global south and the global north. We represent diverse constituencies and perspectives: this paper focuses on the issues of concern shared by all endorsing organisations.¹

While the paper concentrates on recommendations for upstream norm-setting, reporting, monitoring, policy making and learning in line with the DAC's mandate, we are equally concerned with the downstream implementation of Private Sector Instruments (PSIs),² and will continue to engage with ODA providers on such issues through different channels, including the OECD's on-going programme of work on blended finance.

A. Introduction

The private sector can, in the right context and with the right regulatory framework and checks and balances in place, make important contributions to sustainable development, the eradication of poverty, and the reduction of inequalities – including by providing decent jobs and livelihoods, and by paying taxes that support governments to deliver essential public services.

However, donors' use of Official Development Assistance (ODA) to subsidise private sector engagement in development through PSIs poses significant risks. These include:

- The diversion of ODA away from its core mandate of the eradication of poverty and reduction of inequalities, interfering with fulfilment of donors' agreed international commitments, including the commitment to 'leave no one behind'
- A lack of clear added value (either in terms of financial or development additionality)
- Unintended side-effects for development effectiveness principles (such as democratic local ownership, transparency and accountability), human rights, the environment, conflict and fragility, debt sustainability, illicit financial flows, and tax avoidance
- An increase in informally tied ODA
- Increased privatisation or commercialisation of social sectors, undermining the development objectives of ODA

These risks are further exacerbated by the fact that as yet there are no clear rules to govern the use of PSI. To this date, the DAC has only agreed on top line 'principles' for counting PSIs as ODA³, and has failed to agree on a set of implementation rules.

The inclusion of PSI in ODA without such rules is highly problematic: it risks undermining the quality of ODA and its impact on poverty reduction, jeopardizing the concept of collectively agreed reporting rules, and affecting the credibility of OECD data. Ineffective use of ODA ultimately undermines the instrument altogether. In our past positions, we have argued that in the absence of clarity on implementation rules, safeguards and incentives, there is a strong case for counting PSI as Other Official Flows, rather than ODA.⁴ In the interests of transparency, accountability and the integrity of ODA, we urge the DAC to **resolve critical issues on the implementation rules, with a particular focus on the critical issues outlined below, and to agree on a time-bound plan to take the work forward** with proper consultation mechanisms in place, consistent with the Framework for DAC-CSO Dialogue⁵, by:

¹ A list of endorsing organisations is at the end of the document.

² PSIs are loans, investments, or guarantees aimed to support private sector actors operating in the global south

³ These top line principles are outlined in the Communiqués of the 2016 and 2017 DAC HLM

⁴ [Joint civil society submission to the 2017 High Level Meeting of the OECD Development Assistance Committee](#), October 2017, paragraph 3.2

⁵ OECD DAC, [Framework for Dialogue between the DAC and Civil Society Organisations](#)

Both:

- (i) Reaching agreement on the priority issues outlined in section B below, which fall within the scope of the 'Phase 1' of the DAC's negotiation process.

And crucially also:

- (ii) Agreeing a time-bound plan for addressing outstanding qualitative issues, corresponding closely to those identified for resolution under 'Phase 2' of the negotiation process, with proper consultation mechanisms in place, consistent with the Framework for DAC-CSO Dialogue.⁶

B. Priority issues for urgent agreement

1. We realise that the Communiqués of the 2016 and 2017 High Level Meetings allow reporting on either an instrumental or an institutional basis. However, we have serious concerns over the latter approach. The institutional basis will lead to significant issues of transparency and the potential for an unrealistic inflation of ODA with the inclusion of activities that do not meet the criteria for ODA. Our position is that **the institutional approach should not be allowed**.
2. Concessionality is a defining feature of ODA: upholding it is necessary to maintain a clear distinction between ODA and commercial transactions. To qualify as ODA, the terms of the PSI must be better than those provided by the market (i.e. concessional). Additionality, though important, should never be used as a substitute for concessionality in determining ODA eligibility – all the more since additionality is fraught with measurement challenges (see point 7 below). If concessional support to the private sector is deemed to pose too many risks from a competition perspective, then we would argue that ODA is not the appropriate way to finance PSI. We urge that, as the DAC sets the calculation parameters for sovereign loans, **concessionality be retained as a core principle**: only PSIs that present an element of concessionality should be ODA-eligible, and only the grant equivalent of such PSIs should be counted as ODA.
3. In recognition that discussions and analysis at the DAC around the eligibility of **equity, mezzanine finance and guarantees** have not been completed yet, we ask that these instruments **should not be included in the PSI rules**. We also ask that the **new rules firmly exclude export-credits**, given that export credits schemes are designed to benefit donor firms and have domestic trade, rather than development impact, as their main objective.
4. To provide a strong safeguard not to inflate ODA with the counting of profitable PSI, we call on the DAC to abide by its 2016 High Level Meeting decision that **profits and dividends paid back to Government should count as negative ODA**.⁷
5. Financial additionality and development additionality are both centrally important factors in assessing the outcomes of PSI - as the OECD DAC Blended Finance Principles recognise.⁸ In contrast, value additionality – defined as non-financial contribution through for example provision of knowledge and expertise, board participation and links to local networks – is a less stringent measure, as most development finance institutions could be expected to claim some such contribution. We ask the DAC's reporting requirements on additionality **should not allow value additionality to be used as a substitute for financial additionality**.
6. Financial and developmental additionality are essential features of PSI, but their measurement is challenging and subjective. We urge the DAC to **strengthen the reporting and evaluation requirements on additionality** by insisting that:
 - a. Clear criteria for assessing financial and development additionality should be established for each project (as per OECD DAC Blended Finance Principle 5).⁹ Criteria for development additionality should specify which development objectives are the focus for the PSI, and how the investment aligns to the SDG pledge of 'leaving no-one behind'.

⁷ OECD DAC, [2016 High Level Meeting Communiqué](#), Annex I principle vii

⁸ OECD DAC, [Blended Finance Principles](#) 1 and 2

⁹ OECD DAC, [Blended Finance Principles](#), 5

- b. Expected additionality should be assessed before investment, and publicly disclosed including in the CRS (see point 7 below).
 - c. Assessments of additionality both at the DAC level and the donor level should be carried out by parties independent of the donor that reports PSI as ODA. At the DAC level, this should be an integral part of the biennial institutional assessment, not just a supplementary consideration used to achieve a good understanding of the institution's functioning and operations.
7. One of the main arguments advanced in favour of the PSI reform was that it would improve the quality of ODA data. This makes it essential to put in place **comprehensive reporting requirements that allow meaningful public scrutiny of how ODA for PSIs is being spent**. When reporting ODA-eligible PSIs in the OECD Creditor Reporting System (CRS), donors should provide the following information, which in turn should be publicly available in the CRS online database.

(i) CRS reporting requirements to align PSI with other ODA reporting

- The investment vehicle used
- The portion of a PSI being counted as ODA ('ODA credit')
- The PSI's development objectives
- Amount tied/untied/partially untied
- Information on the policy implications of PSI, using the full range of available policy markers (including both required and voluntary markers)

(ii) Additional CRS requirements to respond to the high risks inherent in PSI:

- The recipient of the PSI, with information on which country the company is based in, on its beneficial ownership, and on its scale
- The financial terms of the PSI investment
- The estimated amounts mobilised from the private sector
- In cases where multiple actors are involved in the PSI operation:
 - Who all the involved actors are, both public and private, from financial intermediaries to ultimate beneficiaries, with information on whether they are public or private, which country they are based in, and their beneficial ownership.
 - Volumes of funding provided by each actor;
 - Financial terms of each individual investment
 - Any facility or fund through which the funding is pooled and channelled to investees
- The PSI's expected additionality (financial and developmental). See our comments on additionality at point 6 above.

Full transparency over PSI would also require disclosures outside the scope of the CRS database. We also urge that:

- Development finance institutions (DFIs) should work towards full transparency over their portfolios, to ensure proper accountability. This includes publicly disclosing contracts involving ODA¹⁰, and making their current and future standards easily accessible for all citizens, in both the global north and global south. This means that standards should be available on their respective websites as well as on request, and should be translated into the official languages of the targeted countries.
- Donors and development finance institutions should never invest in companies and funds unless they are willing to report their financial accounts on a country by country basis. As an intermediate step, the donor should forward the country by country reports to all relevant tax authorities, including the local tax authorities, and eventually, this information should be placed in the public domain for all stakeholders to access.

¹⁰ Oxfam (2018) , Open books, How development finance institutions can be transparent in their financial intermediary lending, and why they should be, <https://www.oxfam.org/fr/node/9419>

C. On the outstanding issues for attention in the near future

8. The complexity of PSI risks creating new loopholes for the tying of ODA (i.e. using ODA in ways that give firms in the donor country an unfair advantage), and risks distorting the balance of support towards firms based in the global north, at the expense of those in the global south.¹¹ Consistent with the DAC's longstanding commitments on untying ODA, we call on the DAC to take urgent steps in 2019 to **analyse the risks of informal tying or other north-south distortions associated with delivering ODA through PSIs, and to put in place comprehensive mitigations**, with processes in place for consultation with CSOs and independent experts.
9. As past CSO analyses have highlighted,¹² PSIs can have unintended consequences that are harmful for sustainable development, including:
- Diversion of ODA away from its core mandate of the eradication of poverty and reduction of inequalities, thereby interfering with fulfilment of donors' agreed international commitments, including the commitment to 'leave no one behind'
 - Erosion of development effectiveness principles, particularly democratic local ownership, accountability and transparency (see point 6)
 - Transgression of human rights obligations and environmental standards, sometimes exacerbating the poverty already faced by local communities¹³
 - Complicating situations of conflict and fragility
 - Debt sustainability risks in countries where PSIs are deployed
 - Illicit financial flows including tax avoidance by the actors involved

In view of these particularly high risks associated with PSIs, we urge the DAC, DAC donors and their DFIs to **put in place robust checks and balances to protect against such unintended consequences**, and to ensure the accountability of all stakeholders. In addition to the transparency requirements in point 6 above, these should include:

- Upstream checks, in each donor agency, on whether the use of ODA for PSI is the best way to use concessional public finance to respond to local priorities in the countries where they operate (with particular attention paid to the priorities of people who are experiencing marginalisation)¹⁴
- Checks at the outset of any individual investment, at both the DAC level (e.g. by strengthening coverage of the above risks in the institutional assessment template, and by involving independent voices including civil society organisations and trade unions in relevant parts of the institutional assessment procedure, and by making the institutional assessment findings public) and the donor level (e.g. by covering these issues in due diligence and project appraisal processes such as environmental and social impact studies and implementation plans).
- Real-time controls, particularly at the donor level, such as the use of independent civil society watchdogs to ensure compliance with environmental and social impact plans.
- Retrospective controls, here too at both the DAC level (e.g. a thorough and independent examination of potential unintended consequences as part of the biennial additionality review on a random sample of a significant number of projects from each development finance institution) and the donor level (evaluations). If – through independent assessment – significant transgressions are identified, the ODA eligibility of the institution in question should be revoked.

More generally, the risks associated with PSIs highlighted above (paragraphs 8, and 9) should be thoroughly scrutinised through the DAC's regular peer review and statistical peer review processes, as well as through the GPEDC monitoring, with urgent corrective action taken where any problems are identified.

¹¹ Eurodad, '[Development Untied: Unleashing the catalytic power of Official Development Assistance through renewed action on untying](#)', September 2018

¹² For example, '[CSO expectations for the new PSI rules, June 2017](#)'

¹³ For example, see Actionaid, '[New Alliance, new risks of land grabs](#)'

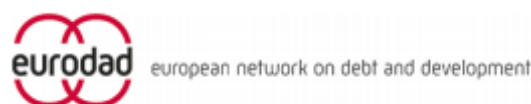
¹⁴ Eurodad, '[Mixed Messages: the rhetoric and the reality of using blended finance to 'leave no-one behind'](#)'

10. Finally, given the current data gaps around PSI, and the far-reaching implications of the new rules, it will be essential to monitor closely what impact the rules are having in practice. We would welcome a thorough review of the PSI rules two years after they come into effect, with the possibility to make amendments. **We call for the DAC to agree terms of reference and budget for the review (to take place in 2021) before it concludes its negotiations in 2018.** Civil society, trade unions and governments of countries in the global south should participate meaningfully throughout the review process, and the review should include a random sample of a significant number of projects from each development finance institution, so that it is possible to make an in-depth analysis of the risks that:

- PSIs are diverting ODA away from its core mandate (drawing on quantitative data¹⁵ and also qualitative data to identify distributional consequences)
- PSIs are not achieving financial and development additionality
- PSIs are having unintended side-effects for development effectiveness, human rights, the environment, conflict and fragility, debt sustainability, illicit financial flows, and tax avoidance
- PSIs lead to an increase in informally tied ODA
- An increased use of PSI leads to the privatisation or commercialisation of social sectors, undermining the development objectives of ODA

The DAC should keep on the table the option of removing PSIs from ODA and reallocating them to Other Official Flows, depending on the review's findings.

Endorsed by:



¹⁵ Using 2017 data – the last before the 2017 HLM decision took effect – as the baseline