CSO expectations for the new PSI rules, 1 June 2017

The Organisation for Economic Cooperation and Development Development Assistance Committee (OECD DAC) is seeking agreement on new rules for reporting 'Private Sector Instruments' (PSIs) – loans, investments, or guarantees to support private sector actors acting in developing countries – as Official Development Assistance (ODA). If the right safeguards are not in place, these new rules put the credibility of ODA at stake. In this paper, we highlight fundamental issues that Civil Society Organisations expect the new rules to address, if the essential characteristics of ODA are to be safeguarded.[1]

Fairly representing donor effort

The principle that ODA should fairly reflect donor effort, over and above actions that would have been motivated by market forces alone, is core to the definition of ODA. Yet, despite some improvements, the current PSI proposals still risk offering generous ODA credit for transactions on near-market terms – potentially undermining both the integrity of ODA and the competitiveness of the market. We call for:

- The **reference rates and minimum thresholds for PSI loans to be more closely aligned with the mechanisms recently agreed by the DAC for sovereign lending,** to 'maintain a clear distinction between ODA and commercially motivated flows', as mandated at the 2016 HLM.
- The decision on **guarantees, equities and mezzanine finance to be deferred to Phase 2 of the decision process**. The current proposals would make radical changes to the way these instruments are reported, without adequate time for analysis or consultation (indeed, the Task Force Terms of Reference did not even propose that a decision on equities and mezzanine could be made within the Phase 1 timescale). We also call for **guarantees only to be recorded as ODA when they are called**, to provide a realistic representation of donor effort.[2]

Prioritising the economic development and welfare of developing countries

The 2016 HLM Communique argued that PSIs could promote the economic development and welfare of developing countries, by mobilising private sector "ideas, … ingenuity and … entrepreneurial energy", and leveraging the resources needed to achieve the Sustainable Development Goals (SDGs) and "leave no-one behind".[3] But strong safeguards and monitoring must be in place to ensure PSIs are living up to these promised benefits and to avoid unintended consequences. The following risks need particular attention:

- **PSIs may not deliver their expected development or financial additionality**. To deliver on the theory of change implied in the 2016 HLM Communique, PSIs must mobilise additional resources, and/or deliver greater development impacts than the private or public sectors could achieve in isolation, thereby helping deliver the SDG agenda, including for those 'left behind'. Yet recent assessments of existing PSIs show actual results have often fallen well short of these objectives.[4]
- **PSIs may undermine the agreed development effectiveness principle of country ownership.** Past studies have found that projects financed through PSIs were not always well aligned to national policies,[5] and that at times they fostered the creation of parallel procedures.[6]
- **PSIs may not meet development effectiveness standards on transparency and accountability.** Many Development Finance Institutions have been criticised for a lack of transparency that makes it very difficult for Southern governments and the public to hold them to account.[7]

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[1] The paper draws on and updates previous civil society positions both from Northern and Southern coalitions at the following links: https://docs.google.com/document/d/1ynqfI6n2WTRKwSMLNRyyJgp_8Jx1UewUssfljeBUmOU/edit and https://drive.google.com/file/d/0B4hU_Yivka3-OXRQMC02TTFFcHc/view

[2] Only when they are called, do guarantees represent a flow of resources to developing countries. Guarantees that are not called represent a source of cashflow for donor countries, but an opportunity cost for development, as the funds set aside for the guarantee cannot be used for other development activities

[3] DAC HLM Communique, February 19, 2016, Annex I: https://www.oecd.org/dac/DAC-HLM-Communique-2016.pdf

[4] See for example European Commission, Evaluation of Blending, Main Report, December 2016: https://ec.europa.eu/europeaid/sites/devco/files/evaluation-blending-volume1_en.pdf, and also Eurodad and Oxfam International, 2016, Blended Finance: What it is, how it works, and where it is used: http://www.eurodad.org/files/pdf/58a1e294657ab.pdf

[5] Eurodad/Oxfam, as above

[6] European Commission, as above

[7] Eurodad/Oxfam, as above; and Romero M, 2014, A Private Affair: http://www.eurodad.org/files/pdf/1546237-a-private-affair-shining-a-light-on-the-shadowy-institutions-giving-public-support-to-private-companies-and-taking-over-the-development-agenda.pdf

- **PSIs may lead to an increase in the level of de facto tied aid.** The DAC's own analysis of existing aid instruments suggests that the risk of de facto tying is significant.[8]
- **PSIs may have unintended fiscal consequences.** Part of the motivation for the new PSI rules is to mobilise additional finance for the SDGs. But activities funded through PSIs also risk eroding the finance that is available to developing country governments, by introducing unsustainable levels of debt,[9] or through tax avoidance by the corporations involved.[10]
- **PSIs may have negative environmental and social externalities,** including human rights abuses, large carbon footprints, and crowding out local private sector actors. Yet not all major PSI-funded programmes have basic safeguards such as exclusion lists or stringent energy efficiency standards.[11]
- **PSIs may divert ODA from other essential purposes.** The new PSI rules will make a major change to the incentives in the ODA reporting system, and the effects on donor behaviour are hard to predict. It will be essential to monitor that PSIs are not diverting scarce ODA resources from essential public services critical to reducing poverty and inequality or other activities that Southern constituencies prioritise.

We call for the DAC to make five key commitments to help mitigate these risks, before the Phase 1 proposals are finalised:

- First, the **institutional assessment of Development Finance Institutions' ODA eligibility** should be strengthened to include compulsory questions on national ownership of development priorities; policies on debt sustainability and responsible corporate tax behaviour; and environmental and social safeguards. Completed institutional assessments should be disclosed publicly.
- Second, **public transparency on PSIs should be strengthened**, with sufficiently disaggregated, timely and complete data to allow meaningful scrutiny and accountability against the risks set out above.
- Third, the rules should include an **explicit statement that PSI can never be tied**, even if highly concessional, to remove any potential loopholes.
- Fourth, DAC donors and their DFIs should commit at the HLM to **strengthen public-private dialogue at country level about PSI investment**, to ensure that any PSIs are aligned with national priorities at strategic level.
- Finally, the **terms of reference and budget for the review of the new PSI rules, due in 2019, should be agreed**, and should ensure in-depth consideration of all the risks above, with meaningful participation of civil society and Southern governments throughout the review process. Development additionality and ODA diversion risks require particularly close scrutiny.[12]

Some stakeholders have argued that if the decision on the new PSI rules is pushed back, this will delay essential financing for the 2030 Agenda. But our analysis suggests that if the DAC rushes into the new rules before fundamental aid quality questions have been addressed, the long-term risks for Agenda 2030 will be even greater.

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[8] OECD DAC, 2017, Report on the Untying Recommendation: http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DCD/DAC(2017)6/FINAL&docLanguage=En

[9] Romero M, 2014, A Dangerous Blend: http://www.eurodad.org/files/pdf/1546054-a-dangerous-blend-the-eu-s-agenda-to-blend-public-development-finance-with-private-finance.pdf

[10] Latindad et al, 2016, Development Finance Institutions and Responsible Corporate Tax Behaviour: http://www.counter-balance.org/wp-content/uploads/2016/11/bp-dfis-responsible-corporate-tax101116-en.pdf

[11] CSO paper on the finalisation of the European Fund for Sustainable Development Regulation, April 2017: http://eurodad.org/files/pdf/58f75ebc4ca05.pdf; Oxfam, 2016, Private Finance - Blending for Development: https://www.oxfam.org/sites/www.oxfam.org/files/bp-private-finance-blending-for-development-130217-en.pdf; TUDCN-RSCD/CPDE, The development effectiveness of supporting the private sector with ODA funds, 2016: http://www.ituc-csi.org/IMG/pdf/tudcn-dfi_study_web_en.pdf

[12] The review should be conducted in collaboration with the Global Partnership for Effective Development Cooperation, where issues fall within its mandate for monitoring development effectiveness.

Endorsed by: