

An Irish Development Bank?

**A paper prepared for Dóchas
by Andy Storey and Simon Williams
(Centre for Development Studies, UCD)**

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1. Introduction

In March 2006, The Minister of State for Development Cooperation announced his possible interest in the creation of an Irish Development Bank (DB), to encourage private sector investment in developing countries. The DB would, it is envisaged, provide loans to projects and activities not served by traditional financial institutions, including commercial banks. The Minister was responding to two proposals from the private sector concerning the establishment of such a DB, with both proposals being made in the context of the consultation process surrounding the White Paper on Overseas Development Assistance (ODA). The Minister stopped short of definitively supporting the proposals but he was reported to be “impressed” by them, and commented that “The idea of an Irish development bank needs to be closely examined and carefully evaluated” (see O’Halloran, 2006).

The present paper aims to highlight the key challenges and opportunities associated with the possible creation of an Irish DB. It provides a comprehensive overview of the activities of similar institutions in other EU countries and relates those activities to some wider debates in development studies about development financing.

2. Development Banks in Europe: European Development Finance Institutions (EDFI)

Fourteen national development finance institutions are grouped together in the EDFI, a coordinating body based in Brussels since 1992 and which seeks to foster cooperation between the different national development banks. According to the EDFI, there are certain key commonalities between the national members:

“EDFI Members are majority controlled by their respective governments, some with private shareholders, and are mandated to provide loan finance to private investors and to invest in private sector enterprises. To set the example for business excellence, expertise and probity, EDFI Members operate under strict market discipline, have a self-sustaining capital base and are expected to make a return on their investments. The principal business of EDFI Members is the provision and structuring of finance for investment in the private sector, or the commercially-run public sector, of non-mature economies”.¹

As well as providing financial support of their own, the EDFI members may also facilitate the participation in financing packages of private institutional investors, including commercial banks and private equity funds. Furthermore, since 2004, 10 members of the EDFI have formed a joint venture company – European Financing Partners (EFP) – with the European Investment Bank (EIB) to support projects in the Africa, Caribbean and Pacific (ACP) countries with which the European Union (EU) has a special relationship under the Cotonou (formerly Lomé) Agreement. Any of the

¹ This quotation is from the EDFI website (www.edfi.be) Unless otherwise stated, all information in this section is drawn from this website and from the websites of the individual EDFI members – a full listing of these websites is provided at the end of this paper.

promoting partners of the EFP (i.e., any of the 10 EDFI Participants) may apply for, and draw down, EFP funding for projects it is sponsoring – thus, additional finance, over and above the capacity of an individual member, may be leveraged for a particular project.

While EDFI members are expected to be resolutely committed to market principles, the chairman of the EFP also highlights their claimed commitment to other goals:

“EDFI members also have a mandate to promote good corporate governance, and environmental and social best practice rules. Indeed, several EDFI members have triple bottom lines (economic, social and environmental), and yet remain very successful on their return on investment, thereby proving that a sustainable development approach to business works equally well in the developing countries”.

How does the actual record of EDFI members measure up to these claims? Is sustainable development genuinely part of their agendas? What activities are promoted, and in what ways? The following pages profile each of the 14 EDFI members; as well as basic background, one or more examples of their project activities is provided wherever possible.

2.1 AWS (Austria Wirtschaftsservice Gesellschaft mbH): Austria

AWS is wholly owned by the government of Austria. AWS follows the recommendations of the Austrian Council for Research and Technology Development in choosing companies and researchers to support. The bank can bear risks directly itself, or use its guarantees against default to mobilise additional capital. The focus of the bank is explicitly on supporting *Austrian* firms. It provides funding for Austria's companies to expand their activities overseas, offers consulting for entrepreneurs in all stages of company development, and promotes and communicates innovation and technology. Just over half (52%) of the firms AWS supports are located in the new EU member states. The bank focuses particularly on the development of technology start-up firms and fostering the commercialisation of new technology in Austria.

2.2 Belgische Investeringsmaatschappij voor Ontwikkelingslanden (BIO) and Société Belge d'Investissement International S.A. Belgian Corporation for International Investment (SBI-BMI): Belgium

a) BIO is a 50:50 public-private partnership between the Belgian Government – through the Department of Development Cooperation – and the Belgian Corporation for International Investment (see below). BIO is supervised by two government commissioners, one appointed by the Minister of Development Cooperation and the other by the Minister of Budget. By end-2004, BIO had a committed portfolio of €49 million, with around €22 million committed to microfinance projects and around €27 million committed to Small and Medium sized Enterprises (SMEs).

BIO operates both direct and indirect investments. Indirect investments are made through a development fund to financial institutions (banks, venture capital funds, micro-finance institutions etc.). A network of microfinancing institutions is financed through this fund. Direct investments are made in SMEs with perceived growth potential. The bank provides equity to private companies and financial institutions, taking a minority stake (generally not more than 35%). The bank's SME fund can also provide direct credit to SMEs. Investments range between €45,000 and €700,000. Financial interventions are conditional on their leading directly or indirectly to sustainable productive employment and are untied to the involvement of Belgian firms (but see the discussion of SBI-BMI below). BIO is active in over 30 developing countries, with a special emphasis on the partner countries of the Belgian aid programme. BIO does not have a specific sectoral focus, but the bank's main target groups are micro, small and medium-sized enterprises.

In 2005, BIO signed a contract with the Rwandan Government to launch REIC, a company targeting the development and expansion of small enterprises in Rwanda. REIC participates in equity and issues long-term loans. Investments range between \$100,000 and \$500,000 per project. SMEs can also apply to REIC for technical assistance and training support for personnel.

- b) SBI-BMI's equity capital currently amounts to €33 million. It is a semi-public investment company, whose major shareholders include Belgian public institutions, the Federal Investment Company and the Central Bank of Belgium as well as private companies. The bank takes minority equity and or quasi-equity (mezzanine financing and profit sharing loans) stakes in firms. Financing per project ranges between €0.5 and €2.5 million. These equity and quasi-equity investments make up 65% of the bank's investment activity, with direct loans to firms accounting for the remaining 35%. The bank's main objective is to co-invest in, and to provide long-term co-financing for, foreign investments by Belgian companies. SBI-BMI's current clients are mainly medium-sized Belgian companies, and its geographical target market includes any country which provides important business opportunities for Belgian companies. SBI-BMI tries to concentrate on those sectors in which Belgian companies have built up know-how which is in demand abroad.

In 2004, Belgian company SIAT SA acquired three state-owned agro-industrial companies in Gabon, active in palm oil, rubber and cattle raising. SBI-BMI, along with the German DEG development bank (see below), provided €4 million through purchasing equity in the company and providing loans.

2.3 CDC: United Kingdom

CDC has built up a portfolio valued in excess of US\$2 billion. It currently has funds deployed in 250 companies in 60 countries. CDC operates as a 'funder of funds' – it does not invest directly in companies but places capital with third-party fund managers. Since 2004, CDC investments have largely been contracted out to one particular fund management company – Actis – which is a limited liability partnership between the company itself (management and staff) and government (DFID has a 40% stake). Currently, CDC monies (mainly handled through Actis) are committed to more than 35 separate funds in Africa, Asia and Latin America. In 2004, the CDC had \$770 million invested in Africa through six funds, \$461 million in South Asia through four funds, \$391 million in Latin America through four funds, and \$223 million in the Asia-Pacific region through four funds. Particular funds have particular foci, such as SMEs, resource extraction, or energy supply. The bank aims to target 70% of funds at the poorest countries in the world (annual per capita income less than \$1,750) and 30% of funds at poor countries (annual per capita income less than \$9,075). At present, Africa, as a region, is the single largest recipient of funds. The CDC is wholly owned by the UK government in the form of the Department for International Development (DFID), and DFID has a 40% stake in Actis, but the boards of directors are independent of government.

CDC recently made a \$5 million commitment to African Lion II, an equity investment company that specialises in early stage investments in gold, base metal, coal, industrial minerals and diamond mining opportunities in Africa. ACTIS investments include Globeleq, a firm that manages and operates Umeme, the privatised Ugandan electricity distribution network.

2.4 COFIDES Compañía Española de Financiación del Desarrollo: Spain

COFIDES is majority owned (61%) by the Spanish government through three public institutions: the Spanish Institute for Foreign Trade, the Institute for Official Credit and the National Innovation Enterprise. The remaining 39% ownership stake is held by the three largest commercial banks in Spain: BBVA, SCH and Banco Sabadel.

The bank operates by directly investing its own resources, taking a minority stake in projects that it supports. This type of equity or quasi-equity investment (capital investment with a combination of equity and loan features) makes up 92% of the bank's investment activity. The bank also mobilises third party funds, including managing co-financing facilities established with Multilateral Financial Institutions such as the EIB. The direct support that the bank provides derives from its administration of Spanish government trust funds established to support Spanish investments abroad. Thus, as with Austria (see above), and many other DBs (see below), the bank ties investments to projects that promote domestic Spanish companies'

investments overseas. The bank focuses on supporting Spanish firms rather than specific sectors. Sixty per cent of the bank's investments go to Latin America.

Unión Española de Explosivos (UEE) is one of the world's largest producers of explosives for civil works. UEE has recently established two installations in Kazakhstan to provide civil use explosives to the country's mining sector, in particular to Kazakhmys Corp., manager of the country's largest copper mine. Cofides supported this project, its first in Central Asia, through a €2.3 million loan.

2.5 Corvinus International Investment Ltd.: Hungary

Corvinus is wholly state owned. It enters into co-investments with Hungarian industrial investors in foreign countries as a minority stakeholder, though the bank and its investment partner must *together* control a majority stake in the target company. The largest single investments that the bank makes are around €8 million. The stated focus of the bank's equity investments is "to facilitate foreign direct investments by Hungarian companies, to create, acquire or develop ventures abroad". Corvinus invests primarily in Central and Eastern European economies but has no particular sectoral focus.

The bank recently invested in a four star hotel in Romania with the British-owned Hungarian hotel chain Danubius.

2.6 DEG, a member of KfW Bankengruppe (banking group): Germany

DEG is one of the largest development finance institutions in Europe. It has worked with over 1200 companies and provided some €6.2 billion in finance. At the end of 2004 DEG had financial commitments of €563 million. DEG is a subsidiary of KfW, a state owned German bank. The board of supervisory directors of the parent bank KfW is made up largely of members appointed by the government, including the chairman and deputy chairman.

The bulk of DEG's investment activity is in tailor-made long term loans. The bank also engages in equity participation (investing capital to become a shareholder), typically taking up around a 5-25% shareholding in profitable projects and occasionally taking up a seat on the board of directors. The bank's mandate does not make any special provision for promoting German firms. Nor does DEG have any particular geographical focus, having financed investments in over 100 developing countries. DEG invests in all sectors of the economy, with special attention to agribusiness, infrastructure and processing industries as well as the financial sector.

The Aga Khan Fund for Economic Development (AKFED), with which DEG has cooperated for over 20 years on various projects, is the majority shareholder in Industrial Promotion Services Kenya Ltd. (IPSK). This is an investment company that acquires equity shareholdings in the industrial

sector and in infrastructure projects. DEG provided the increase in capital required for IPSK to enlarge its equity portfolio in Kenya and expand into Tanzania and Uganda. Through its seat on the board of directors it plays an active role in determining IPSK's business policy and evaluating and selecting projects.

2.7 Finnfund: Finland

For the year 2004, Finnfund had disbursements of €29 million, and at the end of the year the bank had a portfolio valued at €91 million. The state of Finland owns a 79.9% share in Finnfund. Finnvera, the state owned official export credit agency of Finland, owns 20% and the Confederation of Finnish Industries owns 0.1%. The majority of members of the board of directors of Finnfund are senior civil servants at the Ministry of Foreign Affairs. About half of Finnfund's investments are equity investments, taking no more than a 30% stake in companies. Once operations have been established, typically after a 5 to 10 year holding period, Finnfund exits according to terms agreed prior to investment. The other half of Finnfund's investments are in medium and long term loans at market rates.

The bank's strategy for 2002-07 states that:

"It [Finnfund] will deepen its know-how in industries that are important for internationalising Finnish companies and increase its presence in those countries where it has the best opportunities of producing added value for its Finnish stakeholders in a cost-effective manner".

If a project sponsor is not a Finnish parent company, some other link to Finnish interests must be demonstrated. Finnfund prioritises low income and lower-middle income countries. Finnfund also targets (but does not limit itself to) the renewable energy, telecommunications and forestry sectors.

Finnfund recently provided a €4 million loan to Nordvod, a company established to implement a waste water treatment plant in St. Petersburg as a public-private partnership. Finnish construction companies YIT and NCC, and Finish financing company Nefco, own shares in the company along with Vodocanal, the St. Petersburg municipal water company. The Finnish Nordic Investment Bank (NIB) is leading the bank consortium in charge of financing.

2.8 The Netherlands Development Finance Company (FMO): the Netherlands

FMO has an investment portfolio of almost €2 billion, making it one of the largest bilateral development banks worldwide. The Dutch State holds 51% of its shares while the large Dutch banks hold 42%; the remaining 7% are held by employers' associations and trade unions and by some 100 Dutch companies and individual investors. The board of supervisory directors of the

bank is appointed at a meeting of shareholders. The bank's investment criteria are expected to dovetail with the government's policy on development cooperation.

The bank makes equity investments in private companies, taking a minority interest of 10% to 35%: this makes up 13% of the bank's investments. The bank also provides loans, usually no more than 25% of required capital – this accounts for about 62% of the bank's investments. Guarantees make up 11% of the bank's investments, whereby the bank guarantees up to 25% of a firm's balance sheet or investment plan. Mezzanine financing (for example, loans that may be realised as shares in a company should the company default) makes up 14% of the bank's investments.² There is no requirement to support specifically Dutch companies. FMO focuses its activities on 40 countries in Africa, Asia, Europe, Latin America & the Caribbean, and also focuses on the financial sector, micro and small enterprises, infrastructure and trade and industry.³

In 2005, FMO participated in a syndicated loan of €40 million to the state owned Ghana Water Company. The company is responsible for drinking water supply in Cape Coast, an area with 300,000 inhabitants. The firm aims to make 4,600 new connections with the investment. A condition of the loan was that Ghana Water Company agreed to privatise the management of their 90 urban water distribution systems.

2.9 The Industrialisation Fund for Developing Countries (IFU) and The Investment Fund for Central and Eastern Europe (IØ): Denmark

IØ focuses on countries in Central and Eastern Europe, while host countries of IFU investments must be on the OECD DAC list of development aid recipients (and with the exception of South Africa, GNP per capita may not exceed \$2,604).⁴ The total equity capital for the two funds amounts to €379 million. Both IFU and IØ are wholly state owned but are officially independent, self-governing entities. However, the Minister for Foreign Affairs appoints the Supervisory Board and the Managing Director to both organisations.

Equity and quasi equity investments make up 68% of IØ and IFU financing, with typical stakes in projects not exceeding 30%. The maximum single investment is around €6.7 million. The bank also offers loans for up to 5 or 7 years at commercial interest rates. It is a condition for IFU/IØ participation in a project that there is a Danish co-investor. The institutions do not focus on particular sectors but rather on commercial viability.

² Mezzanine (mid-way) finance is any form of finance that shares some of the features of both equity and loan finance.

³ Some sources in the Netherlands indicate that FMO is excessively risk-averse and lacking in localised networks that could deal with local entrepreneurs – instead, all contact goes through the Netherlands.

⁴ In 2004, an independent evaluation was critical of the IFU for not investing sufficiently in the poorest countries, though this is a common problem: to function, DBs require the presence of an embryonic business sector, a framework of legal protection and other factors that may not necessarily be present in the poorest countries.

IFU recently took part in a joint venture in China with Danish brewer Carlsberg and local partner Tibet Galaxy, founding a brewery aimed at supplying a growing market for beer in Tibet (the subject of a controversial occupation by China). IFU has also participated in a joint venture with Danish company, The East Asiatic Company (EAC), to produce and sell substitute breast milk (infant formula) on the Chinese market, again a subject of potential controversy. IFU sold its shares to EAC once the company was up and running.

2.10 Swedfund International AB (Swedfund): Sweden

Swedfund at the end of 2004 had a total invested portfolio of around €55 million. Swedfund is owned by the Swedish state and representatives of the Ministry of Finance and the Ministry of Foreign Affairs sit on the board of directors. The bank's role and terms of reference are determined by government policy on global development.

Around 71% of Swedfund investments are direct equity investments, always taking a minority stake in companies. Loans are also offered to companies investing in developing countries. Swedfund cooperates with the Swedish Trade Council and is represented by it in some countries; the Council seeks to make it easier for Swedish companies to grow internationally. Swedfund concentrates on countries with a per capita GDP of under \$3,000 but this limit does not apply to Central and Eastern Europe. Around a third of Swedfund investments are in Central and Eastern Europe, with just over a third in Africa, and 15% in each of Latin America and Asia. In total, Swedfund has investments in 27 countries and, potentially, in all sectors (to the exclusion of alcohol, tobacco or armaments).

Swedfund took part in the privatisation of the state telephone operator, Enitel, in Nicaragua, after it was brought by the partly Swedish owned company, Megatel, in 2001. Swedfund invested nearly €1 million in the company. In 2003, Swedfund and co-financiers loaned Enitel a total of \$30 million which was used to repay supply credits to Ericsson (also a Swedish company), which had supplied equipment for expansion of the network.

2.11 Società Italiana per le Imprese all'Estero (SIMEST): Italy

SIMEST at the end of 2004 held equity interests valued at €157.3 million in 199 companies (equity investment makes up 100% of SIMEST's activity). SIMEST's private sector shareholders include major Italian banks and business organisations, but it is controlled by the Italian Ministry for Productive Affairs.

SIMEST can acquire up to 25% of the equity capital in firms outside the EU, whether wholly owned by Italian companies or set up as joint ventures with local companies. Venture capital funds of the Italian Ministry of Productive Affairs, also managed by SIMEST, may be added to SIMEST's own equity

investments in foreign firms (up to 49% of shareholding). The overt aim of the bank is to “promote Italian investments abroad and support them technologically and financially”. Preference is given to countries that according to the bank, “by tradition and culture, offer a conducive environment for Italian investments and are of particular geographic and economic importance for the internationalisation of the Italian productive system”. SIMEST’s investment activities have no particular sectoral focus, though in 2004 new investment projects were mainly in the engineering, textiles and clothing, building/construction, services and chemicals/pharmaceuticals sectors.

The Italian Goglio Group will soon establish a new production facility in China. The facility will produce sterile packaging for the agricultural and foodstuff sector, mainly for distribution onto the domestic market. The Italian partner has launched a major market penetration strategy to promote the commodity in China. The total investment stands at €19.2 million, of which SIMEST’s share amounts to €3.8 million.

2.12 Norfund: Norway

Norfund has capital of approximately €330 million and, by the end of 2004, had 41 investments. The bank is organised as a hybrid state-owned company and the board of directors is appointed by the Norwegian parliament. The decision-making structure of the bank is therefore influenced by government.

Norfund finances projects directly through equity as well as indirectly through lending funds. The bank typically provides 10-35% of the capital for a project and always takes a minority stake. The bank also offers quasi-equity (investments combining loan and equity features). Equity and quasi-equity make up 77% of the bank’s investments, and loans the remaining 23%. The bank does not stipulate that Norwegian companies must be involved in the bank’s investments. Any country with a per capita GDP of under \$5,290 is eligible for investment and the bank aims to make a third of its investments in least developed countries, concentrating on priority partner countries for Norway’s development cooperation programme. Norfund has no specific sectoral focus; however, through an interest in Statkraft Norfund Power Invest AS, Norfund contributes to constructing, modernising and operating hydro-power facilities in developing countries.

In 2003, Norfund provided a loan of almost €400,000 to Norwegian company Interkraft Nepal AS, in order to assist in buying 75% of the shares in Butwal Power Company (BPC) together with Nepalese partners. BPC operates several hydropower stations in Nepal, and currently supplies electricity to about 100,000 people there. The investment, according to bank documentation, has provided the Norwegian energy industry with access to a South Asian market that has highly profitable prospects.

2.13 Société de Promotion et de Participation pour la Coopération Economique (PROPARCO): France

PROPARCO's equity portfolio is €72.7 million and the bank's total lending is €497 million. The Agence Française de Développement (AFD), a French government development finance institution, owns a 68% share in the bank. The remaining shares are owned by French finance institutions, other French companies and International Financial Institutions (IFIs). The AFD has two permanent positions on the board of directors of the bank. The Ministry of Economic Affairs and the Ministry of Finance are also represented on the board.

Loans make up 82% of the bank's investment activity and may take any form, including mezzanine finance. Average maturities are between 8 and 10 years. Guarantees and equity participation each make up 9% of the bank's investments. The bank always remains a minority investor when it buys equity in companies. Guarantees take the form of offering investors security on their financial return, thereby leveraging additional capital flows into projects. There is no stated special provision made to tie investments to French companies. Proparco operates in over 60 States in Africa, the Mediterranean Basin, South-east Asia, The Pacific, the Indian Ocean, the Caribbean and the 9 overseas departments, territories and territorial communities of the French state. The bank has highlighted infrastructure, the financial sector, manufacturing, digital and telecommunications services, infrastructure, private healthcare and private education as priorities for investment.

PROPARCO along with Orascom, a Mauritian bank, Club Méditerranée and the EIB are financing the construction of a Club Med hotel on the island of Mauritius. The total cost of the project is estimated at €51 million.

3. Issues Arising

Amongst the issues arising from the above review are the following:

- Half⁵ of the EDFI actors include the **promotion of their national firms abroad** as part of their mission and remit. In the case of at least 2 other countries – Sweden and Norway – there are strong, if less formal, connections to domestic corporate interests. While this linkage would not necessarily negate a positive developmental impact, it would certainly suggest that many development banks do not see development as their sole raison d'être.
- Some of the **specific activities supported** (and the examples cited above are not intended to be representative) **are likely to raise particular concerns** amongst many development agencies, including projects in Tibet, the promotion of breast milk

⁵ Including one of the Belgian banks, and both Danish ones.

substitutes, and water sector privatisation (which has been associated in many cases with *reduced* services and investment levels, and job losses).⁶

At the same time, it will also be apparent from the above review that there is **huge diversity within the EDFI sector** as regards governance structures, geographical and sectoral foci, and methods of providing financing support (for example, the balance between loan and equity support). Thus, it is difficult to draw firm conclusions on the appropriateness, or appropriate form, of an Irish DB on the basis of the above alone, though the question is begged of whether Ireland needs such a bank at all. Additional guidance can, however, be obtained from practitioner and published perspectives on these issues. Broadly speaking, these perspectives fall into two categories – practical issues of management, and wider issues concerning global trends in development financing.

3.1 Practical issues: the devil in the detail

Altenburg (2005) claims that public-private partnerships for development (and DBs typically constitute an example of such) yield 3 potentially significant advantages: increased resources; deployment of extra expertise (generally from the private sector) for development ends; and innovative approaches that traditional aid organisations and actors would not have arrived at. However, Altenburg (2005) also notes that public-private partnerships run the risk of public resources being squandered on activities private sector operators would have engaged in anyway, what might be termed the ‘windfall waste’ problem.

One person interviewed for this paper, who has extensive experience of working on enterprise development and development financing, provided an excellent summary of this and other practical problems confronting development banks:

“as a mechanism for supporting the private sector it [a DB] is notoriously inefficient. One of the main arguments against, which tends to be borne out in practice, is that they end up with the.. non-viable projects that the main banks will not touch. Or, if they are more careful in their financial analysis, but are offering cheaper credit, they get all the good projects which would anyhow have got funding through the normal banking system. . The bad debt record of most development banks is poor, and this can create major long term problems in an economy, leaving a foot print of ‘SMEs do not repay their debts’. The argument in favour is that normal commercial banks particularly in developing countries, do not tend to lend to small projects. There are quite possibly projects which are viable, but do not have collateral (an extremely old fashioned way of lending anyhow). The area is pretty highly developed at this stage, with working models that include some equity finance, along with some loans. The equity component is important, because typically the sort of projects that are quite possibly viable but have no hope of accessing normal bank finance, would also have difficulties handling a large loan in the early years, as payment of interest and capital is

⁶ See, for example, Hall and Lobina (2006) for a discussion of this issue.

likely to be impossible with small cashflow generation. Banks should still take a very commercial approach, backing up loans with good mentoring and monitoring systems – don't just lend the money and leave them to it. The approach that is now used a lot is to operate development credit lines through existing banks, backing this up with training for the bank officials etc – in other words training up officials to lend against good business cases, instead of against collateral. Pro is that they already have the distribution networks, admin etc, so it's cheaper. Contra is... the possibility that banks may just direct their favourite customers to this lovely cheap credit. This is very much a micro issue rather than a macro issue – the principle is possibly fine, but the devil is most certainly in the detail – lending criteria, repayment requirements, degree of bank control on the business...”

The myriad practical details – including the need for equity support, capacity building for local financial networks, and the importance of mentoring and monitoring – that are touched upon in this quotation will be returned to in the concluding section of this paper.

3.2 The bigger picture: commercialising aid?

The World Bank is strongly positive about the potential role of private finance for development, pointing, for example, to the need to “tap the potential of international capital markets to provide greater participation in financing for the poorest countries” (World Bank, 2005: 107). The Bank highlights the facilitative role that could be played in this regard by loan guarantee agencies and, as the review above highlighted, this is one of the roles played by some DBs.

A number of other commentators have, however, raised concerns about a claimed shift in development financing from public (and therefore, potentially at least, democratic) control to private initiative. Soederberg (2004 and 2005), for example, makes the claim that foreign aid has increasingly been privatised in recent decades. Turning specifically to development banking, Mosley (2001) suggests that the privatisation (or transformation into a public-private partnership) of the CDC in 1997 in the UK was a significant development in this regard. Cammack (2001) goes further and sees CDC activities as a way of promoting capitalist profit expansion at a global level, an end that might not be compatible with objectives of poverty reduction. A variation on Cammack's argument is Bracking's (2003) claim that development finance institutions constitute vehicles for ensuring Northern commercial interests reap commercial returns at the *expense* of the global South i.e. this form of development financing is here seen as *directly* prejudicial to Southern development interests.

These are not arguments that can readily be resolved – the debate about whether capitalism is a progressive force for development, or the cause of poverty in the South, is one that has raged in development studies for many decades. How these wider debates might be responded to in the context of the DB proposal is returned to in the next section.

4. Conclusions

While inevitably tentative and provisional, a number of conclusions nonetheless suggest themselves on the basis of the evidence reviewed to date. These are organised on the basis of lessons learned from existing EDFI agencies; practical, managerial issues; and the wider debates about development financing.

4.1 Recommendation 1: Avoid Bad Practice

A number of practices currently serve to discredit, and limit the developmental impact, of some existing EDFI members. We would suggest that, as a minimum, the Irish government should consider that any initiative it may develop based on current examples of development finance institutions, should avoid bad practice. In our view, any Development Bank should avoid the following:

- **Activities that appear to retard rather than promote development.** These include investment in the production or distribution of products such as infant formulas. They could also include investment in geographical areas that are under occupation (Tibet) or the subject of international boycotts, save in exceptional circumstances. Also usefully excluded could be activities where an emerging body of evidence suggests detrimental results are occurring, or, at the very least, significant questions are being raised – this might cover programmes to transfer public services (such as water provision) into private hands.
- **The tying of finance to the promotion of the commercial interests of Irish companies** – tied aid invariably reduces the value of aid and serves to undermine broad public support for aid programmes (this would especially be the case for an Irish aid programme that has historically been untied in nature).⁷ It might also be prudent for an Irish DB to cooperate most closely with like-minded DBs in other countries, including those which also operate untied support (the Dutch FMO might be a case in point).

4.2 Recommendation 2: Follow Good Practice

In order to maximise developmental impact, any Development Bank should observe certain operating principles. These include:

- **Only extending finance where there is plausible evidence of unmet needs for development finance** that are not being satisfied by existing financial networks. DBs should, ideally, ‘lead’ rather than ‘follow’ capital flows. This is to avoid the problems of undercutting indigenous financial institutions, and also the possibility of generating ‘windfall profits’ for activities that would have gone ahead anyway. In practice, this could well translate into a focus

⁷ It may also, of course, boost support for the aid programme from the commercial interests thus assisted.

on micro-enterprises and SMEs, whose ability to raise funding is often less than that of larger concerns.

- **Disbursing finance through existing, local networks and ensuring capacity-building for those networks.** This would have a dual purpose: first, to avail of local expertise to best target support; second, to promote the long-term sustainable development of local financial institutions. Given that these local networks would need to be carefully chosen and worked with closely, there may well be an argument for an Irish DB concentrating its efforts on a small number of countries where some local knowledge has already been acquired (perhaps Irish Aid's existing partner countries) and working local relationships perhaps already initiated.
- **Again in cooperation with local actors, going beyond simple financing support and also offering, where appropriate, mentoring, monitoring and other 'hand-holding' supports** necessary to overcome the supply-side constraints (which are rarely limited to capital alone) that bedevil enterprises in the South. This could possibly be done in cooperation with non-banking specialists, including micro-finance experts and organisations in the South.
- **Offering equity financing in order to overcome the problems of limited collateral and limited cash-flow during the early stages of enterprise development.** This is a crucial issue: *long-term* finance is especially important for young businesses in young economies. And it may mean that the DB requires long-term funding itself – long-term, fixed-rate finance could be available to the DB through, for example, its access to state guarantees.

4.3 Privatising aid?

As mentioned above, it is a clear concern within development circles that DBs can become vehicles for the greater commercialisation of development finance. Therefore, if an Irish DB were to be established there may be a case for clearly separating a DB from a 'mainstream' aid programme, thus limiting dangers of the main part of Irish aid acquiring a commercial (rather than poverty reduction) focus. The DB could be run as an independent body (perhaps on an 'outsourced' basis), albeit with board representation from aid (official and NGO) personnel to ensure developmental considerations were not lost sight of in its activities.⁸ In this way, a clear line could be drawn between a new initiative that would offer a very different approach to development financing, and an aid programme that could remain definitively focused on meeting the needs of the poorest.

⁸ It might also be useful to consider an annual 'social audit' of the DB, assessing its social, environmental and developmental impacts as well as its economic performance. This could be undertaken by people with expertise in aid and development, and complement the standard auditing practices of financial experts.

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