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Synthesis Report on Policy Recommendations for New Ways of Global Engagement

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Synthesis Report on Policy Recommendations for New Ways of Global Engagement

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Abstract This synthesis report is one of three synthesis reports relating to Task 2 of Work Package 6. It teases out policy recommendations that emerge from the work undertaken for deliverables D604 to D606. This has included a mapping of the nature of the financial integration of developing countries (Bonizzi et al. 2014), a review of EU development policy (Bonizzi et al. 2015), an assessment of the new roles certain developing countries have in the provision of finance for Europe (Tserkezis and Pitelis 2015; Pitelis and Pitelis 2015; Bonizzi and Toporowski 2016), the changing nature of development finance policies (Van Waeyenberge and Bargawi 2015; Van Waeyenberge 2015; Laskaridis and Toporowksi 2015) and the importance of domestic 'self-finance' of industrial development in BRICs countries (Mudrovna 2015).

Keywords: development finance; development policy; EU; financial integration; EPAs; domestic self-finance.

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1. Introduction

The shock of the global financial crisis (GFC) and its continuing aftermath have rekindled an interest in the issues bearing on financing development, including in the repercussions of specific links between domestic economies, global trends and the world economy for resource mobilisation for growth and development. The trends and dynamics leading up to the financial crisis, and that are often summed up with reference to "financialisation", have had specific manifestations in developing country contexts with important implications for the relationship between the real and financial sector, the way in which the national economy is integrated internationally, the role of the state, and ultimately, the scope to finance development.

The research in Task 2 of Work Package 6 Finance, Development and Global Governance has sought to assess the effect of the evolution of the international financial and monetary system on developing countries since the financial crisis and how that impact is feeding back into modalities of co-operation among developing countries, multilateral trade and development agencies, and the governments of Organisation of Economic Cooperation and Development (OECD) countries and the European Union (EU).

This synthesis report (D609) is one of three synthesis reports relating to Task 2 of Work Pack 6. It teases out policy recommendations that emerge from the work undertaken for deliverables D604 to D606. This has included a mapping of the nature of the financial integration of developing countries (Bonizzi et al. 2014), a review of EU development policy (Bonizzi et al. 2015), an assessment of the new roles certain developing countries have in the provision of finance for Europe (Tserkezis and Pitelis 2015; Pitelis and Pitelis 2015; Bonizzi and Toporowski 2016), the changing nature of development finance policies (Van Waeyenberge and Bargawi 2015; Van Waeyenberge 2015; Laskaridis and Toporowksi 2015) and the importance of domestic 'self-finance' of industrial development in BRICs countries (Mudrovna 2015).

The report proceeds as follows. Section 2 briefly surveys the changing nature of the financial links between the developing and developed world over the last few decades.

Attention is drawn in particular to the rise of private flows (and private indebtedness) as well as to the increased significance of 'reverse' financial integration, where developing countries provide financial flows to developed countries. Section 3 unpacks how these trends have been accompanied by particular policy imperatives steering the nature of the EU's engagement with the developing world. The section first lays out the principles that have steered EU development policy over the last decade and then proceeds to document how these have translated into specific development practices. The latter includes an emphasis on the promotion of financial sector development in developing countries, the rise of blending initiatives, and the nature of the new generation of Economic Partnership Agreements (EPAs). Section four discusses the matters that arise as a result of the trends in international financial integration of developing countries, more generally, and the specific directions of EU policy, in particular.

2 Trends in financial integration of developing countries: from official to private flows and from developed to developing countries and back!

The mix of financial flows to developing countries has changed dramatically since the early 1990s. In the early 1990s, Official Development Assistance (ODA) was the largest external resource flow for almost 100 developing countries, while in 2011 it was the largest for 43 countries (Griffiths et al. 2014, p. 12). Private flows have increased, both in absolute and relative importance compared to ODA and Other Official Flows (OOF) for developing countries as a whole. Evidently, private flows are more volatile, reducing dramatically, for example, immediately after the 2008 GFC.

Figures 1 (a and b) and 2 chart the composition of foreign flows to all developing countries since 1980.

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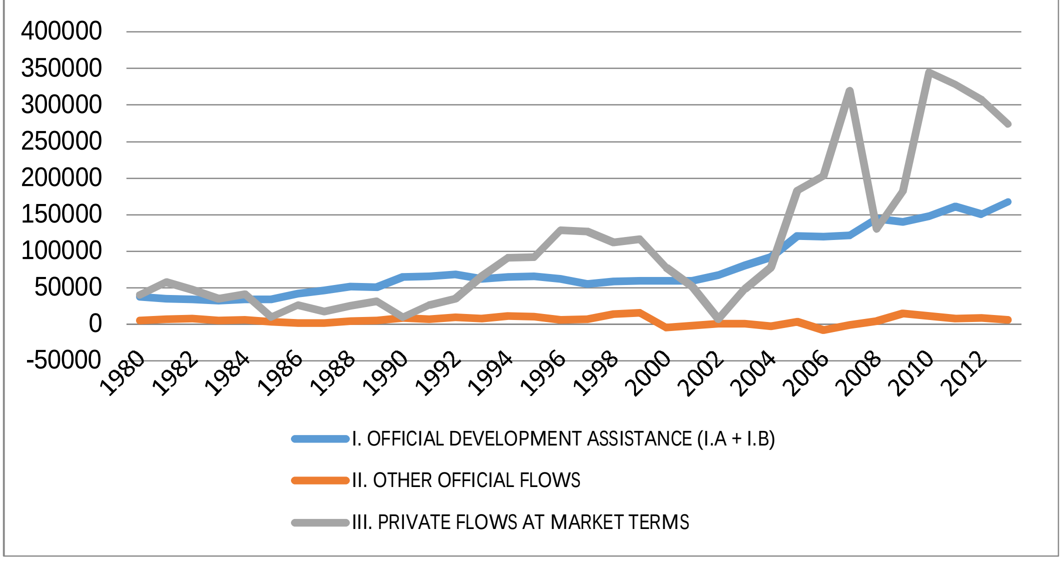

Figure 1a Total flows to all developing countries (current USD millions)

Source: Van Waeyenberge and Bargawi (2015)

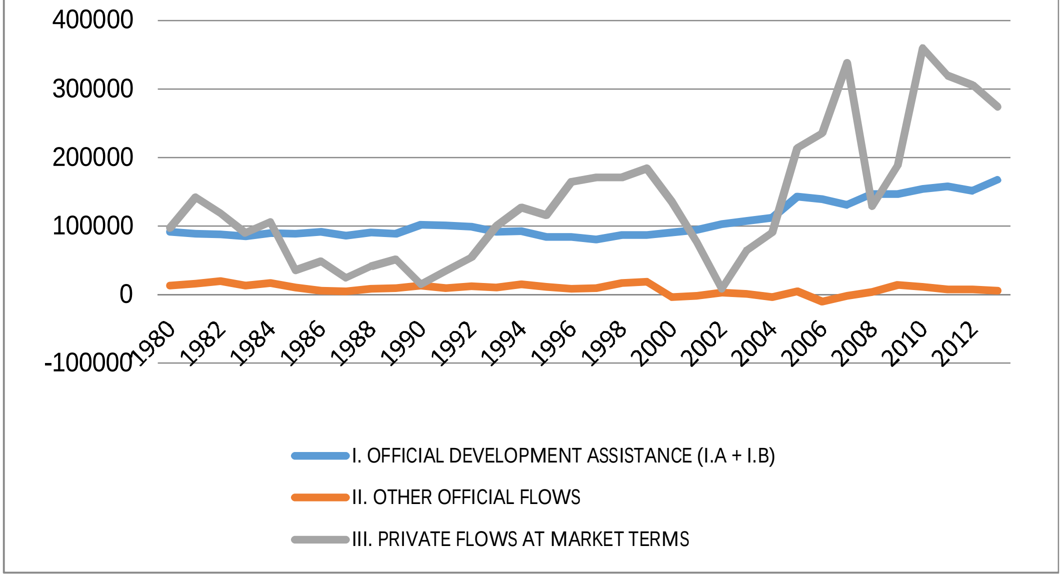

Figure 1b Total flows to all developing countries (constant 2013 USD millions)

Source: Van Waeyenberge and Bargawi (2015)

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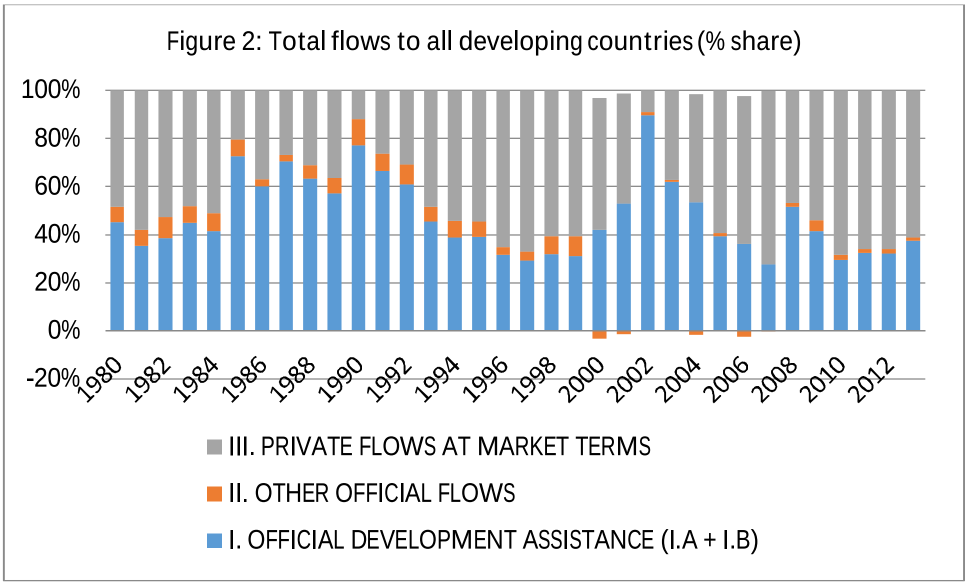
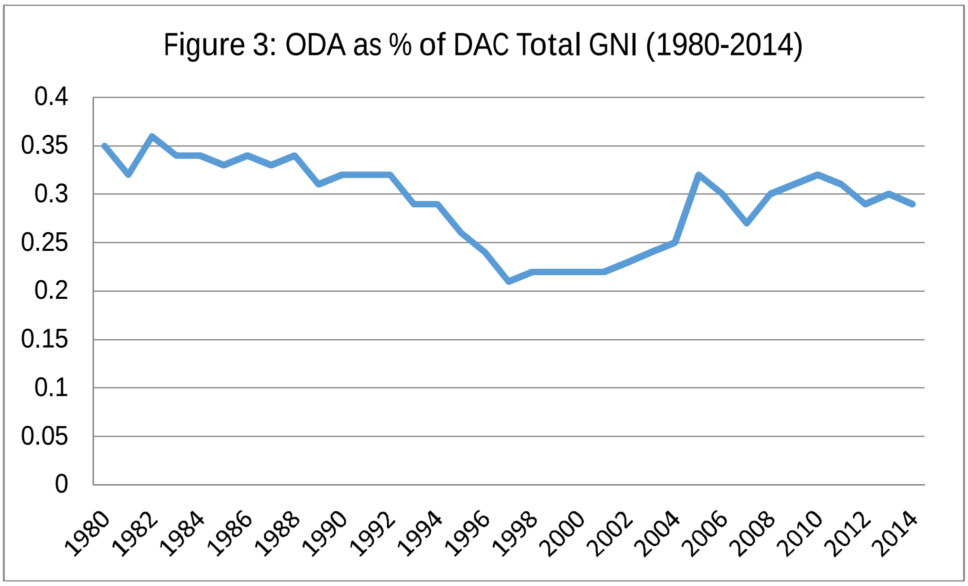


Source: Van Waeyenberge and Bargawi (2015)

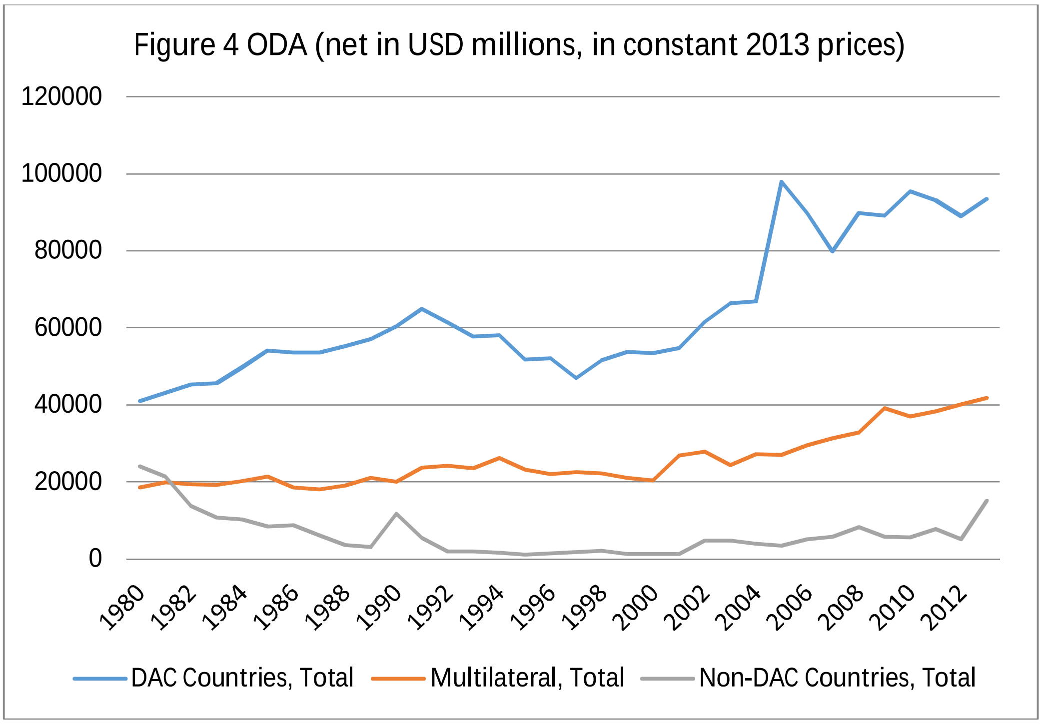
2.1 ODA: lacklustre performance of OECD donors and the rise of new players

Figure 3 traces the changing share of ODA as a percentage of Development Assistance Committee (DAC) Gross National Income (GNI). The trajectory of ODA, considered in this way, has been disappointing. Despite donor rhetoric to the contrary (particularly during the mid-2000s), ODA as percentage of DAC GNI has remained stubbornly below 0.32 percent since 2000.



Source: Van Waeyenberge and Bargawi (2015)

Aid from OECD-DAC donors, including through their contribution to multilateral agencies, has become a less important source of development finance at the global level, despite growing rapidly prior to the global crisis. Non-traditional donors and South-South cooperation have grown in importance, particularly in the wake of the global financial crisis and particularly for certain sectors. Figures 4 and 5 highlight the growth of ODA from non-traditional donors that has been reported to the OECD.



Source: Van Waeyenberge and Bargawi (2015)

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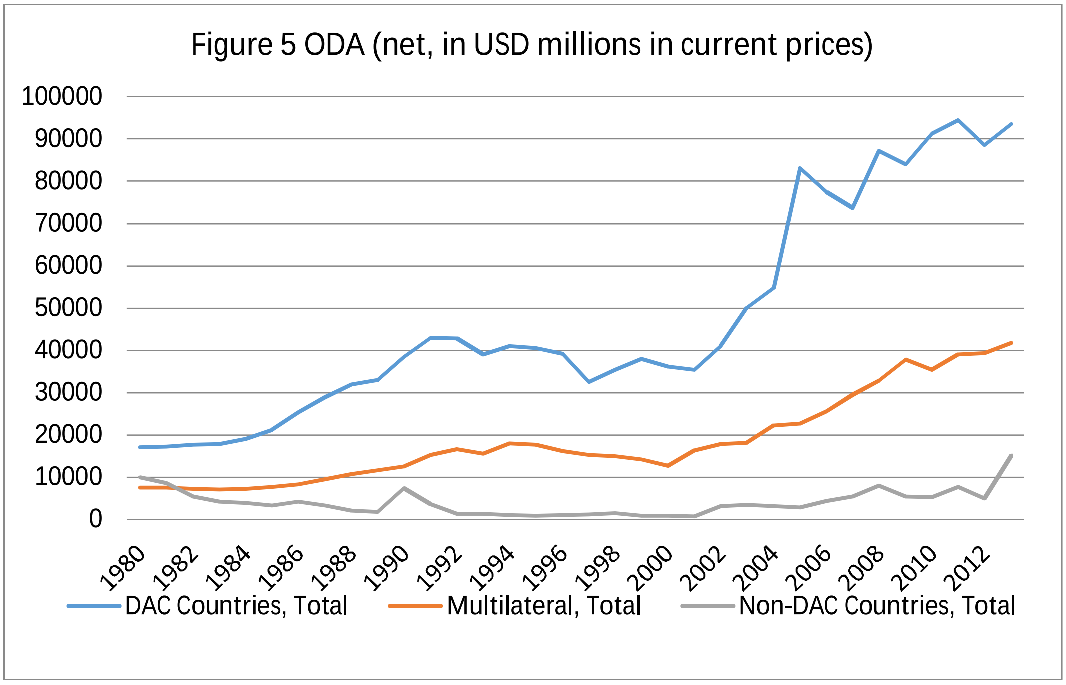


Source: Van Waeyenberge and Bargawi (2015)

By 2013 non-DAC donors accounted for 10 percent of total ODA flowing to developing countries (equivalent to USD 15bn) (see figure 5). Many of these countries, including China, Brazil, India and South Africa, do not systematically report on the levels and geographical distribution of their aid, nor are reporting standards and data methods uniform, making comparisons difficult (ODI 2015).

Non-DAC donors are strong supporters of economic infrastructure as well as commodity aid or general programme assistance. They have a strong presence in power and transport sectors or "hard infrastructure" sectors compared to traditional donors, who had become focused on social sectors during the 1990s and 2000s.

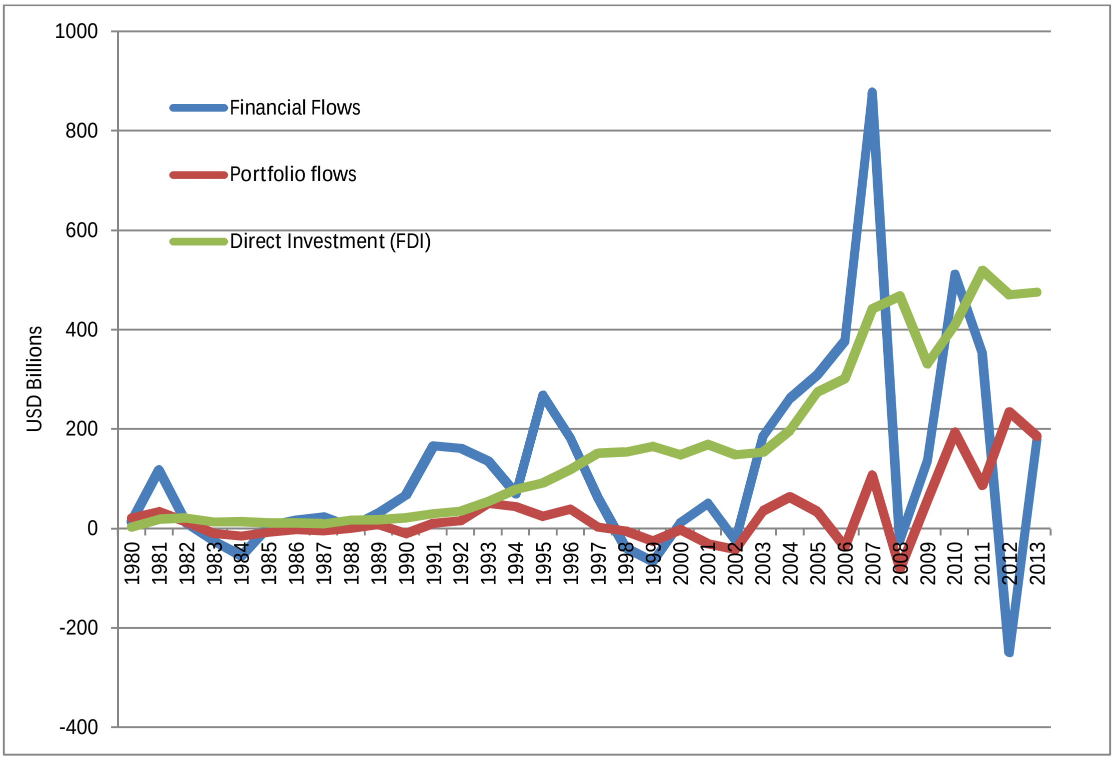
The new role of non-traditional donors is not restricted to their bilateral engagement with developing country partners. The recently constituted BRICS New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB) aim to cater for large unmet needs in the emerging and developing countries in the field of infrastructure and more environmentally sustainable forms of development. Beyond their financial contribution, the development of large and effective BRICS institutions may provide a platform for reforming the aid and development landscape and enhance the potential bargaining power of developing countries as a block (Griffiths-Jones 2014).

2.2 Private financial flows: expansions punctuated by crises

As demonstrated in Figures 1 and 2 above, there has been a fast acceleration of the integration of developing countries in the international financial system in the last two decades. In this context, developing countries are often referred to as Emerging and Developing Economies (EDE), and we will use the terminology interchangeably. A central factor in this accelerated integration has been a surge in private capital inflows to developing countries that started in the early 1990s, but which has been punctuated by strong negative fallouts from various financial crises (including the Mexico crisis in 1994, the East Asia crisis in 1997, Russian crisis in 1998, Brazilian financial crisis 1998-99, Argentinian crisis in 2002 and the 2007-8 global financial crisis). Another feature has been the 'reverse' financial integration of developing countries, where substantial amounts now flow from developing to developed countries, including the EU.

Tyson and McKinley (2014) survey the trends in Foreign Direct Investment (FDI), bank lending (financial flows) and portfolio flows to developing countries, against the backdrop of the internationalisation of the financial system characterising the period from 1980 onwards. While, since the 1980s, there has been a long-term trend towards increased cross-border private capital flows, which came to be celebrated as crucial to development, there are significant differences in growth rates and relative importance across different types of flows. Cross-border private capital flows typically consist of FDI; portfolio flows – composed of equity stakes of various investors including pension funds, mutual funds, insurance companies, hedge funds and commercial banks; and financial (or debt) flows, which are mainly net bank lending (but also include bond issuances).[1]

Figure 6: Net private capital flows to developing countries by type (1980-2013)



Source: Tyson and McKinley (2014)

Between 1980 and 1990, private capital flows remained relatively limited, at an average of US$ 36 billion annually. These flows were dominated during that decade by FDI and bank lending, accounting for 53 and 39 percent of total private cross-border flows respectively. Portfolio flows only accounted for 8 percent of the total private cross-border flows (Tyson and McKinley 2014, p. 16).

During the next decade, 1991-2002, private cross border annual flows accelerated rapidly, to reach an annual average of US$ 220 billion, or 4.5 times the annual average of the 1980s. This acceleration was driven by FDI (accounting for 56 percent of total private cross-border flows) and bank lending (41 percent of total), while portfolio flows remained relatively low. However, FDI was highly concentrated in developing Asia and Latin America, a trend that was to continue until 2013, as these two regions received 43 percent and 27 percent of global FDI respectively (between 1991 and 2013). Commercial bank lending was much more volatile than FDI, expanding initially rapidly if unevenly until 1997 (with a dip for the Mexico crisis in 1994) to collapse during the Asian and Latin American crises of 1997 and 1998 (and again in 2002 with the Argentinean crisis).

Tyson and McKinley (2014) discuss the 2000s in terms of pre- and post-crisis periods. For the period 2003 to 2007, they point to the fast acceleration of private cross-border flow, exceeding US$ 700 billions annually,[2] with commercial bank lending showing exponential growth between 2002 and 2007 – facilitated by the liberalisation of the capital account in various countries. The 2000s also see the arrival of outward FDI from Southern countries, with China leading.[3]

By 2008, the GFC spread to developing countries, being transmitted to these countries through private cross-border flows (as well as through trade and commodity prices). Given that low-income countries had remained relatively on the margins of the fast expansion of cross-border private flows, they remained relatively shielded in terms of the impact on private capital flows. Middle-income countries that had liberalised their financial markets and opened up their capital accounts, however, were strongly impacted by the crisis, as total bank lending contracted sharply in response to the crisis, falling from a peak of $853 billion in 2007 to a mere $9 billion in 2008, and remaining volatile after 2008 (including a net outflow in 2012). Portfolio flows, which had grown during the pre-crisis period, also experienced a sharp contraction initially but resumed strong, if volatile, growth after 2008. Portfolio flows expanded strongly in 2010 and 2011 and, while experiencing a sharp contraction in 2012, increased again in 2013. For Tyson and McKinley (2014, p. 20) these trends reflected "push factors in advanced economies as investors, including those in the shadow banking system, sought yield opportunities outside of advanced economies, where quantitative easing had driven down interest rates and where periodic speculation increased on the assumption of a reversal of such easing, especially in early 2013". Note that while quantitative easing was intended for domestic investment to be stimulated, it enabled expansion of positions in overseas investments.

FDI responded, however, relatively little to the 2007-8 GFC, and, by 2012, post-crisis FDI inflows to developing countries exceeded inflows to developed countries for the first time (Tyson and McKinley 2014, p. 19).

Finally, the contagion of the GFC was not limited to volatility of financial and portfolio flows, but also included sharp changes in financial costs as emerging market debt spreads became more volatile (McKinley and Tyson 2014). McKinley and Tyson (2014, p. 21) observe that "such volatility can cause significant problems for developing countries, especially for government financing, as reliance on private capital flows implies that the cost and availability of financing cannot be ensured since they are subject to rapidly changing market sentiment".

2.3 External debt of the developing world: the rise of private rather than public external debt (but for how long?)

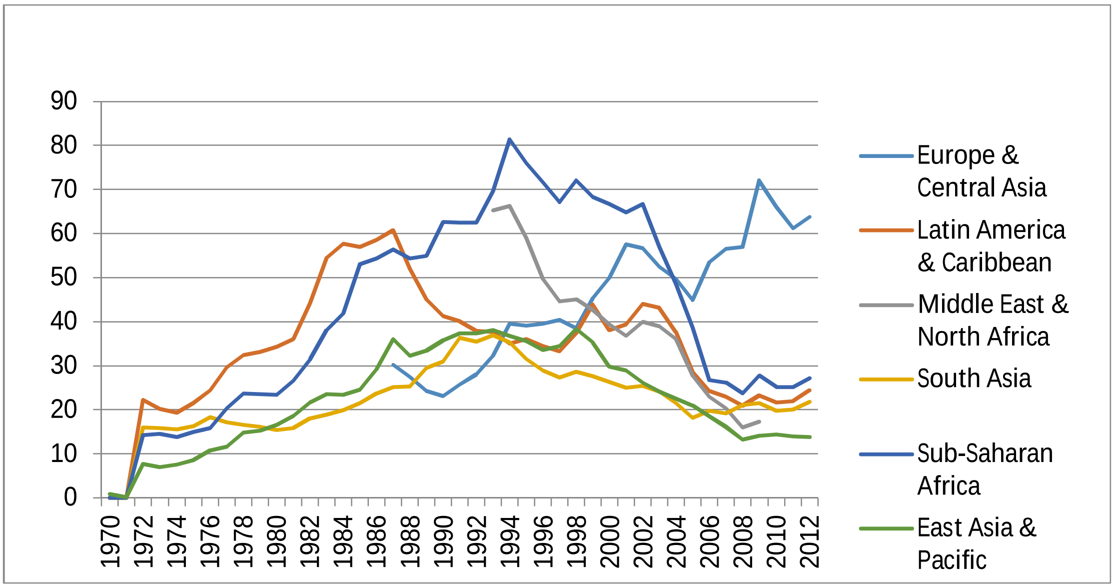
As a result of the trends in private financial flows to developing countries described above, external debt of developing countries has grown steadily since the 1970s, but its rate of growth has rapidly increased since 2002. A large proportion of external debt of EDEs is commercial debt (i.e. owed to the private sector), with official debt under 20 percent of total in recent years (Akyuz 2014, p. 24). International debt securities and bank loans constitute its two principal components. For Akyuz (2014, p. 24) this contrasts to the first boom in capital flows to EDEs in the late 1970s and 1980s, when much of the external commercial debt was accumulated as syndicated bank loans.

Another significant feature of the growth in external debt is the increased proportion of external borrowing undertaken by the private sector. While during the 1970s and 1980s, external debt accumulation in developing countries was mainly through the public sector, from the early 1990s onwards, private sectors of these countries began to borrow abroad. This trend has accelerated rapidly since the mid-2000s (i.e. this proceeded gradually at first to gather a rapid pace from the mid-2000s onwards). While the private sector of developing countries had debts amounting to 5 percent of total external debts in 1989, by 2012, this had surpassed 35 percent of total external debts (Bonizzi et al 2014, p. 8).

A crucial issue then is that the rapid rise in developing countries' external debt position over the last 15 years has been driven by the increases in international borrowing by the private sectors of developing countries (Bonizzi et al 2014; Akyuz 2015, p. 26). I.e. there have been large shifts in the relative shares of the public and private sectors in the external commercial debt of EDEs. For EDEs as a whole the private sector now accounts for the bulk of external debt both in international bank loans and securities.[4] We should add that as interest rates on private debts are higher than on public debt, this reconstitution of the relative evolution of public and private external debt has implications for debt servicing burdens. Since 2007, it has resulted in the majority of debt servicing of developing countries' external debt to be for debts of the private sector (Bonizzi et al 2014, p. 9).

At the same time, however, on aggregate, debt indicators of EDEs have improved over the last three decades (see Bonizzi et al 2014, p. 10) as output grew rapidly across EDEs. External debt stocks as a proportion of GNI have converged for all regions except for Europe and Central Asia. But this masks considerable differences between regions regarding the distribution between public and private external debt. For SSA, for instance, the largest component of its debt has been official bilateral debt of the public sector and official multilateral debt, with more recently increased proportions of external debt being issued by the public sector in the form of bonds, which is marginally surpassed by private sector external bank borrowing (Bonizzi et al 2014, p. 16.)

Figure 7: External debt stocks as share of GNI



Source: Bonizzi et al (2014, p. 12)

It should also be noted that the currency composition of total external debt of EDEs has shifted towards local currencies. Akyuz (2014, p. 27) points towards three reasons for this trend. First, there has been a sharp increase in the share of local-currency bonds and notes in international issues by both governments and corporations. Second, domestic securities issued in foreign currencies or linked to the exchange-rate have become less important. Third, many governments in EDEs have shifted from international debt in foreign currency to domestic debt in local currency and opened domestic debt markets to foreigners (Akyuz 2014, p. 29). These countries have benefited from the increased willingness of international lenders to assume the currency risk and to be under local jurisdiction in return for higher yields and large capital gains (p. 29).

However, since a large proportion of external debt of EDEs remains in bank loans and as these, as well as the official debt, are mainly in foreign currencies, the bulk of total gross external debt for many countries is in foreign currencies despite recent increases in the share of local-currency debt. This is the case in particular for poorer countries dependent on official lending, countries with little developed domestic debt markets or low credit ratings preventing them from attracting foreign investors into domestic debt markets or from issuing local-currency denominated international bonds (Akyuz 2014, p. 33).

Indeed, a lot of the discussion above regarding private cross-border flows during the noughties relates to MICs (with a few countries, including China, Brazil and India often dominating the picture). LICs receive a small yet growing share of private cross-border flows to developing countries. This amounted to 1.8 percent of all private cross-border flows between 2003-2007, but grew to 3.2 percent of all flows in the period 2010-2013. Yet these flows accounted, by 2012, for 6.5 percent of low income countries GDP, above the average of 6 percent for all developing countries (Tyson et al. 2014, p. 7). Net FDI flows to LICs have grown steadily since 2003, standing at six times their 2002 (absolute) level in 2012, accounting for 3.9 percent of total FDI flows to developing countries and 5.2 percent of GDP. These trends include increasing participation in FDI sources from other developing countries, notably China, India and the United Arab Emirates (UAE). FDI to LICs has also somewhat diversified away from its previous focus on extractive industries, to include now also financial services and tourism. This growth in FDI remains however concentrated in a few LICs (including Bangladesh, Cambodia, Mozambique and Tanzania).

Further, 2013 saw a surge in portfolio flows to LICs, which had previously been negligible/ This is the result of LIC sovereign bond issuances, including by Tanzania, Kenya, Rwanda, Mozambique and Uganda (see te Velde 2014). A growing number of LICs, notably in SSA, have issued Eurobonds. Many of these countries did so for the first time, as they take advantage of an expansion in global liquidity, lower interest rates and improvements in global risk appetite. These first-time issues between 2009 and 2013 reached almost $9 billion. While average size was small, at some $450 million, it reached 10 percent of GDP in some of them (Guscina et al. 2014). Such issues however can imply significant currency and refinancing risks.

2.4 Financial flows from developed to developing countries … and back! Reverse financial integration of the developing world

The trends documented above follow widespread liberalisation in developing countries of the rules governing direct and portfolio equity investment. This allowed for an escalation of foreign presence and influence in the real and financial sectors of developing countries. Domestic markets in developing countries have been opened to foreign banks. And as a result of capital account liberalisation, both financial and non-financial corporations have had greater access to international financial markets "flooded with cheap money" in the wake of the GFC and the multiple rounds of quantitative easing by the major monetary institutions in the world.

Another trend that has emerged as a result of the tighter international financial integration of developing countries is various manifestations of reverse financial flows from developing countries to developed countries. These take different forms including through the investment ("recycling") of massive reserves that have been accumulated by countries to (self-)insure against volatility of financial flows and payment crises; the investment by developing countries' sovereign wealth funds in developed countries; and developing country FDI flows towards developed countries. These three manifestations of 'reverse' financial flows are discussed below, with particular attention for their European dimension.

2.4.1 Reverse flows through reserve accumulation

Developing countries' accelerated integration within international capital flows has been accompanied by fast international reserve accumulation (see Bonizzi et al 2014; Tyson and McKinley 2014). The share of international reserves in total external assets of developing countries increased "from less than a quarter in 2000 to 43 percent by 2013" (Akyuz 2014, p. 13). Of some US$ 7 trillion of reserves accumulated after 2000, "almost two-thirds are earned from current account surpluses and one-third are borrowed – i.e. put aside from capital inflows". This implies that over 40 percent of total reserves of developing countries in 2013 were borrowed reserves, which accounts to close to one-half of developing countries' total gross external debt in that year (p. 15). As of 2014, EMDE held about two thirds of total currency reserves. Akyuz (2014, p. 15) comments that this unprecedented reserve accumulation by developing countries:

"goes directly against the prognostications of mainstream theory that the need for international reserves should lessen as countries gained access to international financial markets and became more willing to respond to balance-of-payment shocks by exchange rate adjustments. However, capital account liberalisation and increased access to international financial markets have produced exactly the opposite result. Private capital flows have no doubt allowed larger and more persistent current account deficits in EDEs beyond the levels that could be attained by relying on borrowing from the BWI or bilateral lenders. But this has also meant accumulation of large stocks of external liabilities. Because of pro-cyclical behaviour of international financial markets, EDEs have become highly vulnerable to sudden stops and reversals in capital flows and this increased the need to keep reserves as self-insurance".

Hence, while developing countries have been recipients of large private financial flows, these have been mostly "recycled back" to advanced countries in the form of foreign exchange reserve accumulation (Bonizzi et al 2014, p. 62).[5] For LICs, international reserves reached 9 percent of their GNP in 2012 (Tyson et al. 2014b, p. 4).

Foreign reserves have been accumulated by developing countries at such a rapid pace to protect themselves against the risks associated with increased international financial integration (volatility of financial flows; reduced autonomy in monetary and fiscal policy when a payment crisis occurs; etc.). These reserves however carry high opportunity costs for capital scare countries. They highlight the subordinate role of developing countries in the global financial system: while these countries are recipients of FDI and portfolio investments, they accumulate reserves to prevent and contain the volatility that these investments may induce (Bonizzi and Toporowski 2016, p. 5).

In the context of the reserve accumulation in Euro, issues of whether the Euro can become a global reserve currency have been raised. The prospects of this seemed real prior to 2008, as the expansion of the Eurozone and the EU through increased trade and financial integration presented the Eurozone as a financially and economically stable institution/environment.

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The Euro remains nevertheless the second most important currency after the US dollar, despite the relatively small size of Euro-denominated trade invoicing: the Euro has been the second biggest component of global currency reserves held by Central Banks in their portfolio of foreign exchange reserves. A quarter of global debt securities are denominated in Euro (Bonizzi and Toporowski 2016, p. 7) (just over 60 percent is held in US dollar-denominated reserves).

Foreign reserve accumulation in Euro implies the supply of finance to European financial markets. Tserkezis and Pitelis (2015, p. 15) pick up on this in terms of the scope for official reserves of BRICS countries to provide a reasonable source of funds "for the refinancing of Southern European debt given that these reserves are traditionally managed with a view to stability rather than return" (Tserkezis and Pitelis 2015, p. 15). Bonizzi and Toporowski (2016, p. 8) add that "EMDE may contribute substantially, if indirectly, to provide stable financing conditions that favour economic development in Europe". This process is however heavily dependent on the financial stability outlook of Europe and the share of reserves held by EMDE in Euro-denominated assets has dropped since the first quarter of 2009 (form 29 to 21 percent). This is the result of increasing diversification of reserves and an active policy to decrease the allocation to Euro-denominated assets (Bonizzi and Toporowski 2016, p. 6). The stability of the capital markets to which reserves are allocated matters for decision regarding reserve investments.

For the Euro, the stigmatisation of sovereign debt and the fears of a breakdown of the common currency undermine the attractiveness of Euro-denominated assets (Bonizzi and Toporowski 2016, p. 10). Foreign reserve investment or allocation decisions necessitate caution as the investments need to be easily disposable to allow for foreign exchange interventions. This implies that they are held in liquid and stable securities. Within the Eurozone, they are likely to be held as German and French government bonds. Increased riskiness or volatility of such assets result in a decreasing allocation to these by EMDE central banks. This implies that it is likely that foreign exchange reserves provided less financing to Europe when such financing was most needed, i.e. during sovereign debt crisis (Bonizzi and Toporowski 2016, p. 10). Reserve holders shift out of Euro denominated government bonds when their perceived riskiness increases. Bonizzi and Toporowski (2016, p. 11) sum up as follows: "While the long-run trend sees developing countries diversifying away from heavily dollar-based reserves portfolios, the Euro remains affected by macro-financial 'short-term' issues. The US remains the ultimate global safe asset issuer – indeed the dollar strengthens during crises".

Reserves are crucial in the international investment positions of developing countries, constituting about half of total external assets (Bonizzi and Toporowski 2016, p. 5), but in the last decade or so, other asset categories including portfolio investments, FDI and debt instruments have increased as part of the developing countries' investments abroad. Part of their reserve management has also been diversified into a more mixed portfolio through the establishment of sovereign wealth funds (SWF).

2.4.2 Reverse flows through sovereign wealth funds

SWFs are defined by the European Commission as "state-owned investment vehicles, which manage a diversified portfolio of domestic and international financial assets" (European Commission 2008 quoted in Pitelis and Pitelis 2015, p. 13). SWFs are mostly concentrated in Arab oil-producing countries (Abu Dhabi, Algeria, Dubai, Kuwait, Libya, Qatar and Saudi Arabia), non-Arab oil-producing countries (Norway and Russia) and emerging East Asian economies (China, Hong Kong and Singapore) (Pitelis and Pitelis 2015, p. 14). I.e. there are two kind of nations with SWFs: commodity exporters and countries running fiscal and trade surpluses (p. 14). When the top twenty SWFs are measured by asset size, seven are found in the greater Middle East and nine in the Pacific Rim region and in total, the advanced industrialized states hold more than 40% of all SWF international assets (Drenzer, 2008).

The European Commission (2008 quoted in Pitelis and Pitelis 2015, p. 13) increasingly see SWFs as a source of investment and market liquidity in times of economic downturn. Pitelis and Pitelis (2015, p. 13) observe how this "highlights the changing nature of the economy wordwide and a development which is linked to the appearance of the BRICs and their increasing financial wealth".[6]

Tserkezis and Pitelis (2015) highlight the possibilities offered through SWF participation in debt markets, in particular for the refinancing of the government bonds/debt of Southern European governments (through participation in European sovereign debt markets) (Italy, France, Spain, Portugal, Greece, Ireland). It remains however unclear whether SWFs would be willing to assume such a role of lender of last resort in the countries of the EU periphery, as well as what the implications regarding how these SWFs choose to exercise their influence would be. In this context, Tserkezis and Pitelis (2015, p. 25) argue that "future developments in the EU regulatory framework concerning SWF investments will naturally be of the highest importance (Epstein & Rose 2009, Thatcher 2012), not only because of the significance of this framework per se, but also because these developments will reveal to some extent whether the Union sees SWF as potential partners in the context of a common understanding or as potential enemies from whom it needs to be protected".

2.4.3 Reverse flows through FDI to Europe

Apart from SWF investments, other forms of "reverse" capital flows from EMDE to developed countries and the EU have been taking place. Bonizzi and Toporowski (2016) looked more closely at the role of FDI in these reverse flow.

Europe is a major destination for FDI. At the end of 2013, the EU was the first world region in terms of total inward FDI stocks. However, the crisis has had a negative impact on this reality. The EU share of total inward FDI stocks declined from 38 percent in 2007 to around 30 percent in 2014 (but the EU retains its primacy in the world). The fall is more dramatic in terms of FDI inflows share, falling from 40 to 17 percent over the same period. This means that in 2014, EU was overtaken in its top position by developing Asia and Latin America as recipient of FDI inflows (Bonizzi and Toporowski 2016, p. 12). The global financial crisis heavily hit direct investments into EU companies.[7]

Both non-European developed countries and EMDEs have contributed to an increasing proportion of inward direct investments (Bonizzi and Toporowski 2016, p. 14). The share of EMDEs has increased steadily since 2004 from 2.3 percent to 5.7 percent (in

2012). (Offshore financial centres count for about 8.3 percent of inwards FDI flows and 7.5 percent of inwards stocks over the 2004-2012 period). Overall, EMDE have become an increasingly important source of direct investments to the EU, while, for Bonizzi and Toporowski (2016, p. 16) the decline of intra-EU direct investment suggest a decreasing financing capacity of EU companies. The BRICs account for a significant and growing share of EMDE outward FDI to Europe. Investment promotion agencies in many European countries make special efforts to attract investments from BRIC companies. Yet, these investments remain highly concentrated in the UK and Germany (accounting for 62 percent of total investments) (Pitelis and Pitelis 2015, p. 11).

Within the EMDEs, Asia is the biggest investing region, accounting for about half of total inward FDI positions and the importance of Russia has also increased significantly since 2004. As a share of their own outward FDI, the EU represents a high proportion for Latin America and Russia, which is less so for Asia and Africa. Bonizzi and Toporowski (2016, p. 19) sum up that, overall, "the developing regions invest a relatively stable proportion of their FDI in Europe and most of the increase in FDI from EMDE follows the overall expansion of their economy and openness in terms of outward direct investment". Within these direct investments from EMDE to the EU, the services sector (70 percent), and in particular the financial sector (over 60 percent of latter), dominates. The financial sector alone constitutes about 42 percent of total inward positions and 45 percent of total inflows on average between 2004 and 2012. Manufacturing constitutes a declining share of inwards FDI, accounting for 16 percent of the total (Bonizzi and Toporowski 2016, p. 20).

FDI from EMDEs to the EU has thus been increasing. This is a result of the growth and outward orientation of EMDEs rather than a specific ambition to select Europe as a destination of direct investment (the EU is not showing a growing share of the EMDE FDI allocations). Bonizzi and Toporowski (2016, p. 21) add that "insofar as EMDE are going to experience higher levels of economic growth compared to developed and especially European countries, these trends are likely to continue. Therefore these countries could contribute to the economic development of Europe in the coming years". But insofar that these investments are dominated by the financial sector, it is not likely that this FDI will contribute to providing finance to high value-added firms: the scope for generating economic development from EMDE FDI to the EU then remains small (p. 33).

3 EU policies: celebrating the new financial order

The trends regarding the changing nature of the international financial integration of developing countries described in the section above have been accompanied by a changing conceptualisation of development cooperation in developed countries. Indeed, during the last two decades, we have seen the ascent in the official (Northern) development community of a firm belief in, and strong commitment to, the potential of private flows to finance development. Private flows are now projected as a superior substitute for aid flows, which had traditionally been considered as the more suitable form through which to engage in development finance.

This has combined with a reorientation of (ODA) now understood as key in leveraging private finance for major investments needed for development (such as e.g. in social and economic infrastructure). Increasingly, mechanisms such as Public-Private Partnerships (PPPs) are to be instrumental in pooling resources for these investments. This redefinition of ODA's role has culminated in various contributions around the post-2015 development financing framework, including through the Third Financing for Development (FFD3) summit and various statements by major actors in international development (World Bank and IMF 2015; World Bank 2013; G20 2013; United Nations Conference on Trade and Development 2014b; ODI and UNDP 2014).

Indeed, the international discussions that took place during 2015, during the FFD3 summit in July, the SDG summit in September and the COP21 in December 2015, and which sought to refocus the common goals for international cooperation in development and to reflect on how to finance these goals, emphasized the role of private financial flows in bringing about developmental goals. Mobilising private cross border financial flows is seen as crucial in bringing about eradication of poverty as well as in financing the broader set of Sustainable Development Goals (SDGs). In some respect, mobilising private cross border financial flows and financial deepening have become developmental ends in and of themselves. The lack of access to capital markets that most low income countries face and the vast amounts of funds managed by institutional investors are seen, for example, as needing to be bridged so that developing countries can better access these funds to catalyse development. The rhetoric regarding development focuses on increasing private sector flows and overcoming the barriers that have been holding back investments. In particular, the flows to banking and financial sectors are seen as an integral and increasingly dominant aspect of development policy and practice.

This section discusses this reorientation of development cooperation with a particular focus on the EU. It first lays out the principles that govern EU cooperation. Subsequently it discusses how these principles have been put into practice. This includes a discussion of how the EU has promoted financial sector development in developing countries; how it has promoted the private sector through 'blended' development cooperation practices; and what the nature is of the new generation of EPAs.

3.1 The principles of EU development policy

The evolution of EU development policy can be traced over the course of the following key policy milestones. The European Consensus on Development endorsed by member states in December 2005 sought to establish formally a framework to coordinate aid policies across member states and the EU institutions.[8] It presented the first European document "to contain a shared vision of principles, values and objectives, as well as political aspirations on which the European development aid could be based" (Zemanová 2012, p. 41). The Consensus sought to renew the commitment to increasing ODA, reaffirmed the principles of ownership in development cooperation etc. It also called for the strengthening of synergies between programmes supported by the European Investment Bank (EIB) and other development finance institutions (DFIs) and those financed by the Community.[9]

DFIs are publically owned institutions that lend funds, either at commercial rates or on concessional terms to public and private sector borrowers in developing countries. Their activities traditionally do not count towards ODA as they fail the concessionality threshold and often lend directly to (or take equity positions in) private sector companies. In the context of fostering private participation in developing countries, DFIs seek to mitigate risks of private-led investments. In particular they provide financial resources, advisory services (such as for instance project preparation services), co-financing (equity or debt) and risk mitigation finance (guarantees).

The Agenda for Change endorsed in 2011 (European Commission 2011) further pursued this emphasis wishing to increase the use of blending of loans and grants (mixing EU grants with loans or risk-sharing and guarantee mechanisms). It argued that this would generate substantial financial leverage of EU aid resources to support public and private investments in developing countries. Officially, blending mechanisms are projected as a response to the need to increase the volume of development financing while resources are constrained ("to do more with less"). They seek to promote more speedy aid disbursement as well as for greater flexibility to adapt to changing environments (Bilal and Kratke 2013).

The increased occurrence of blending also aims to respond to the Commission's "differentiation" approach, which seeks to act on the increased heterogeneity across developing countries (see Eurodad 2013). Through this approach, the Commission would concentrate its ODA in LICs, while leveraging other flows to MICs through various blending mechanisms. Blending approaches are however practiced across the spectrum of developing countries.

A 2012 Communication from the Commission to the European Parliament and the Council of Minsters (European Commission 2012) reaffirmed the crucial role of the private sector in development financing. It reasserted the need to mobilise private sector resources for development through innovative ways of funding development including the use of grants to leverage public and private sector resources. This led to the launch in December 2012 of an EU Platform for Blending in External Cooperation with the explicit objective of improving the quality and efficiency of EU external cooperation blending mechanisms.[10]

The Agenda for Change was followed by "A Decent Life for All" (European Commission 2014a), which outlined an EU vision for a post-2015 development framework. Again the Communication emphasised that the private sector remains the key driver of inclusive and sustainable growth. Governments are urged to make full use of the opportunities provided by the private sector, both at domestic and international level. Also, the "catalytic" potential of ODA is to be better exploited through mechanisms like blending. The 2013 Communication Beyond 2015 (European Commission 2013a) focused on how the post-2015 framework is to be financed and offers another example of a proposal for a future financing framework that "reinforces the linkages between public and private finance, and domestic and international resources" (Griffiths et al. 2014, p. 4). For the European Commission (2013a, p. 8):

"Innovative modalities of delivering finance can increase effectiveness and should be scaled up. Blending of grants with loans and equity, as well as guarantee and risk-sharing mechanisms can catalyse private and public investments, and the EU is actively pursuing this."

And while the text continues to assert that private finance is fundamentally different from public finance, and that private interests do not "per se" pursue public policy goals, "a small shift in private investment priorities and modalities could bring about significant benefits to public policy goals". These shifts, for European Commission (2013a), can be achieved primarily through domestic and international policy incentives, such as those offered by public-private partnerships.

The European Commission communication "A Stronger Role of the Private Sector in Achieving Inclusive and Sustainable Growth in Developing Countries" (European Commission 2014/263) published in May 2014 sets out further how to operationalise a vision of development that puts the private sector at its centre. The Communication indicated how the Commission works closely with developing country governments to support them in developing and implementing policies that support private sector development. This includes the deployment of grant funding in support of a range of activities such as regulatory reform, capacity-building, and the provision of business development services (with a projected focus on strengthening local Micro, Small and Medium Enterprises). The Communication also highlights that the Commission is actively seeking new ways to harness the potential of the private sector as a:

"financing partner, implementing agent, advisor or intermediary to achieve more effective and efficient delivery of EU support, not only in the field of local private sector development, but also in other areas of EU development cooperation such as sustainable energy, sustainable agriculture and agribusiness, digital and physical infrastructure, and the green and social sectors" (European Commission 2014b, p.3).

The strategic framework guiding EU development cooperation sees the private sector not solely as a partner but also seeks to assist the private sector in achieving "positive development results as part of its core business strategies". EU programmes should be delivered as much as possible through market-based approaches, which create business opportunities for local (and foreign) entrepreneurs (with a special role for cash transfers in the context of social programmes as these allow for market development by supporting demand) (p. 4).

The Communication (European Commission 2014b) further indicates that the private sector development mission is all-encompassing, applying to most areas of EU support, including in agriculture and agribusiness, sustainable energy, infrastructure and social sectors, and is also prominent in the areas of environment, climate change, migration, risk management, raw materials, natural resources, healthcare and pharmaceuticals, sustainable tourism, and nutrition. The role of the Commission is to:

"develop ways to better integrate private sector development objectives in support strategies, and … identify modalities for using the private sector as an implementing and financing partner in these areas" (p. 9).

This includes the promotion of PPPs through support for legal and regulatory reform, financial instruments to leverage private funding for infrastructure projects, etc., as well as the search for synergies with other aid instruments such as budget support (p. 15).

In a follow-up statement by the Council of the European Union (2014, p. 1) it was re-affirmed that the role of the private sector needed strengthening for the implementation of the future SDGs, as the private sector was now understood to be key to deliver on the "new global partnership" of the post-2015 agenda (see above). To this purpose, the Council urged the Commission to enhance the interaction between the EU and Member States in the promotion of the strategic role attributed to the private sector in development.

3.2 The practices of EU development policy

EU ODA is disbursed through the bilateral aid budgets of individual members as well as through the EU institutions. In 2012, EU institutions and member states collectively spent € 55.2 billion in ODA, with approximately one fifth of this under management by EU institutions. At the level of the European Union, aid comes from two sources: the general community budget (financed by member states' contributions to the budget and own resources of the European Community)[11] and the European Development Fund (EDF). The latter is financed by direct contributions from member states.[12] ODA is disbursed through a set of instruments (see Bonizzi et al 2015) and these are implemented mainly by EuropeAid, which is the Community's external cooperation office created in 2001 and which was merged into DG Development and Cooperation (DEVCO) in 2012.

The European Commission plays the dual role of multilateral/bilateral donor and coordinating body between member states. Through a set of initiatives, the European Commission has sought to increase streamlining of communal and member states' development polices (European Union Centre of North Carolina 2012). In general, the EU seeks to improve coordination between the EU and member states, increasingly through joint programming of aid. It also seeks to make increased use of new funding sources, including blending facilities and private sector funds (European Commission 2014a).

For the EU, the new principles of development cooperation documented above and which celebrate the central role of the private (and financial) sector in development cooperation have translated into a set of development cooperation practices. These are discussed in this section. The section focuses on the promotion of the financial sector in developing countries; the promotion of "blending practices" in development assistance; and the nature of recommendations regarding the financial sector in the new EPAs.

3.2.1 Promoting the financial sector in developing countries

The financial sector constitutes a focal point of EU development cooperation. The financial sector is an important aid recipient from EU institutions (through the EDF and the budgetary allocations through the Multiannual Financial Framework) and its member states. For EU member states ODA allocations, "banking and financial services" account for between 3 and 5 percent between 2008 and 2012. This compares to allocations to health between 4 and 5 percent and water and sanitation for a similar share (Bonizzi et al 2015). For the EU institutions the share allocated to "banking and financial services" increased rapidly over the last few years to reach 10 percent in 2012, as compared to 2 percent for health and 4 percent for water and sanitation that same year.

Within ODA to "banking and financial services", the largest proportion goes directly to financial intermediaries (see Table 1). This share increased rapidly over the last 10 year, going from just under half of all ODA to the financial sector to nearly the entire budget of ODA for the financial sector (94 percent) in 2012.

Table 1: Breakdown of ODA to financial sector (%)

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Financial policy and admin management	12	8	20	9	6	10	9	2	3
Monetary institutions	7	24	0	1	1	0	1	4	1
Formal sector financial intermediaries	46	52	72	73	83	74	72	87	94
Informal / Semi formal F.Is	33	15	7	16	10	15	17	5	2
Education/ Training in Banking & financial services	3	1	2	2	1	1	2	1	0

Source: Bonizzi et al (2015)

Another interesting feature with regard to ODA channelled to the financial sector is the difference between the amounts committed and those actually disbursed. The trend of the past seven years has been for the amounts disbursed to the financial sector to far exceed the amounts that were originally committed for a particular year (see Table 2).

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Table 2: Differences between commitments and disbursements of ODA to the banking and financial sector

Banking and financial sector			
euro million	Committed	Disbursed	Difference %
2007	35.05	54.52	56
2008	13.63	55.27	306
2009	22.67	27.2	20
2010	1.17	33.15	2733
2011	3.27	39.46	1107
2012	32	25.47	-20
2013	35	12.78	-63

Source: Bonizzi et al. (2015)

3.2.1.1 The EU and financial sector development in the Franc Zone

The deployment of ODA to promote financial sector reform was looked at more closely in Laskaridis and Toporowksi (2015) in the context of the Franc Zone and the policies of financial deepening that have taken place there (with the aim of integrating financial and banking markets within the zone).

The Franc Zone consists of a common currency area between two sub regions in Sub Saharan Africa, each with a central bank. It was set up originally in 1948 to provide stable currencies for French colonies. The CFA franc was originally convertible into French francs at a fixed exchange rate, the parity of which has remained unchanged since 1948 with the exception of the 1994 devaluation. Laskaridis and Toporowski (2015, p. 7) observe that "the original justification for the zone was the provision of a currency that would not be vulnerable to inflation and free movement of capital within the zone. The elimination of capital controls in France at the end of the 1980s has implied that in effect the countries of the Franc Zone have open capital accounts with the rest of the world".

Since the 1980s, there have been several dimensions to the promotion of financial sector development in the Franc Zone. This includes the conditionalities bearing on financial sector liberalisation and integration promoted through the Structural Adjustment and Stabilisation programmes of the Bretton Woods Institutions from the 1980s onwards. Laskaridis and Toporowski (2015) also highlight how financial sector development proceeded as strong efforts were made to export the EU model of integration to the Franc Zone after the 1994 devaluation.[13] This included the development of debt markets for governments and the extension of monetary union to other kinds of economic co-operation and financial integration through the creation of the Central African Economic and Monetary Union (CEMAC) and the West African Economic and Monetary Union (WAEMU). Finally, a more recent trend advancing financial sector development in the Franc Zone relates to EU development policy, which has strongly embraced the financial sector development paradigm in its funding programmes.

One particular aspect of the attempts to effect financial deepening and broader regional economic integration in the Franc Zone has been the promotion of government debt markets. Despite traditional hostility to government debt on the basis of crowding-out arguments, government bonds have become recognised as fundamental to broader financial development. Laskaridis and Toporowski (2015, p. 20) highlight how the expansion of local debt markets in the Franc Zone has been prompted by a number of developments, including changes in the rules of how governments finance their expenditures. This includes the prohibition or restrictions on direct monetary financing by the regional central banks. This followed strong encouragement by the international financial community to move towards central bank independence, which limits the direct advances central banks can make to governments. Governments have been encouraged to develop local currency debt markets instead.

In the spectrum of financing of government debt of a low income country, concessional financing is cheaper than domestic government borrowing. Yet, despite the higher costs attached to domestic debt, market-based government debt financing has been strongly promoted by donors as a key element in the financial deepening agenda. The arguments underlying the development of liquid government securities markets include the facilitation of monetary policy implementation and the scope to attract foreign savings into local bond markets. The development of the domestic debt market then becomes a stepping stone in the overall financial development and international financial integration of low income countries. The development of a government securities market facilitates the subsequent development of a private debt market, as government securities provide benchmarks against which private securities can be priced. Laskaridis and Toporowski (2015, p. 22) explicitly observe that: “Although it was popular in the past to argue against the expansion of local government debt, with the most commonly sighted explanation being that domestic government debt crowds out private sector credit, and has negative consequences for private investment, we can observe a decisive shift in the literature, with conflicting views of old literature and new, as it tries to contend with the latest enthusiasm for securitised government debt and market based financial integration”.

Lasarides and Toporowski (2015) add that the development and deepening of domestic financial markets in the Franc Zone has implied the following institutional developments: the instauration in the WAEMU region of a new credit rating system to encourage bond issuance; attempts to reduce institutional barriers; and the development of a mortgage market and securitization programme. As a result, certain countries in the Franc Zone have seen rapid credit growth in the past decade.

In sum, and returning to the broader issue of EU development practices, official flows to the financial sector and the promotion of financial sector development represent important components of EU aid. This reflects the belief that the development of the financial sector plays a crucial role as an engine of economic development.

The next section discusses the rise of “blended finance” as another practice through which the EU has sought to promote private and financial sectors.

3.2.2 The EU and blending practices

Mirroring the private turn described above, various statements on development by the EC increasingly started, from the 2000s onwards, to point to the imperative of exploring synergies between ODA and other (non-concessional) flows to developing countries. This has had implications for the relationship across institutions, in particular the relationship between the agencies traditionally involved in ODA (DEVCO/Europeaid) and the European Investment Bank (EIB) and national DFIs of member states.

DFIs in Europe, including the EIB, have increasingly been drawn upon for synergies of aid management, as private sector development became a principal focus of European development assistance (in line with the private turn more broadly across the OECD donor community and other IFIs). Under the framework of the Cotonou Agreement, for instance, an Investment Facility was set up (in 2003), which placed some of the EDF (i.e ODA) funds under EIB management with a mandate to support private sector development in ACP states "by financing essentially – but not exclusively- private investment" (European Commission 2013b).[14]

The Investment Facility seeks to provide support for the private sector, in particular SMEs through support for the local savings' market but also seeks to facilitate foreign direct investment. In 2012, 43 percent of the Facility's lending went to support for the financial sector in ACP countries, making the financial sector the largest single beneficiary of these investments.[15] These financial intermediaries are meant to act as brokers between the public institution and the private company benefitting from public lending and investments (Eurodad 2013, p. 10). The intermediaries include commercial banks, microfinance institutions and private equity funds. The Facility provides support through debt finance, guarantees, equity-type financing and acts as an investor in private equity funds.[16]

For the EU, the increased deployment of blending mechanisms in development cooperation is a relatively new phenomenon. The Investment Facility, which is under EIB management, is its first manifestation. It has been succeeded by the creation of a series of Blending Facilities since 2007 with the explicit aim to increase private participation in the delivery of development (see Van Waeyenberge 2015; Bonizzi et al 2015).

The principle of the blending mechanism is to combine EU grants or concessional finance (from its budget or EDF programme) with loans or equity from public (non-concessional) or private financiers.[17] The latter include loans by the international, regional and European bilateral financial institutions such as the European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD), Council of Europe Development Bank (CEB), and public national DFIs (such as Nordic Investment Bank (NIB), Agence Française de Développement des Etats de l'Afrique Centrale (AFD) and KfW Bankengruppe) (Ferrer and Behrens 2011).[18]

The EU grant contribution in its blending mechanisms takes different forms, including:

- Investment grant & interest rate subsidy - reducing the initial investment and overall project cost for the partner country;
- Technical assistance - ensuring the quality, efficiency and sustainability of the project;
- Risk capital (i.e. equity & quasi-equity) - attracting additional financing;
- Guarantees - unlocking financing for development by reducing risk.

Further, although the resources involved in blending remain small as compared to the EU's overall ODA budget (at 4 percent of total ODA in 2012), they have increased significantly over the last few years, and the Commission has indicated across various documents that it seeks increasingly to organise its development cooperation around the principle of blending.

The grants in the regional blending facilities have mainly been deployed for infrastructure investment, with transport and energy dominating (followed by water and sanitation). Some facilities also seek to promote access to finance for MSMEs. And, while partners in the beneficiary countries can be public, private or mixed institutions, public partners have dominated the first years of the Facilities, with only 11 percent of the grant contributions disbursed through the Facilities going directly to private sector beneficiaries (ODI 2011; Eurodad 2013, p. 19). However, in 2012, the number of projects granted to private sector partners through the Facilities doubled as compared to 2011 and the European Commission plans a strong increase in this area (Eurodad 2013, p. 11; Rudischhauer 2012). The EU blending platform, which was set up in 2012, for instance, has indicated an interest in pursuing how the private sector can be involved more in the blending mechanisms, either as financier or as beneficiary.

For the European Commission (2014b, p. 16) blending is an important vehicle to leverage additional resources for development as well as increase the impact of EU aid. The Commission further seeks to extend the scope of blending into new areas including the social sectors and agriculture.

In general, "blending" or "leveraging" captures the specific way in which official development cooperation can be used directly to catalyse private flows. The idea is that private sector firms seek investment opportunities on the basis of risk-return considerations and public sector measures are necessary to decrease perceived risk or to increase anticipated returns (see World Bank and IMF 2015). Leveraging can involve a host of different "partners" (including multinationals, commercial banks, etc.) and can take different forms (PPP promotion, guarantee instruments, equity stakes, etc.).

3.2.3 Economic Partnership Agreements

On June 10, 2016 EU Commissioner Cecilia Malmstrom celebrated the signing of the Economic Partnership Agreement (EPA) between the European Union and the South African Development Community (SADC) by stating that "this deal is about making clear that our relationship is a partnership of equals" and that it represented a shift from the practices of the past which represented relationships of a different era (Malmstrom, 2016). The EPAs represent a fundamental change in the interaction of the EU with its former colonies in the African, Caribbean and Pacific regions (ACP countries). They replace the non-reciprocal preferential trade agreements in place since the establishment of the Cotonou Agreement (2000) and seek to comply with WTO standards. Apart from the move from non-reciprocal to reciprocal trade agreements, the EPAs encompass structural issues concerning economic policy at the national level including investment policies. Yet, doubts have been cast regarding the developmental impact of the EPAs. It has been argued that the reciprocal character of the new trade regime will have greater costs than benefits and that it enforces neo-liberal policies that fail to promote the achievement of the SDGs and poverty eradication. These issues are discussed in this section, which first provides an overview of the EPAs and subsequently provides some critical commentary.

3.2.3.1 EPAs: State of play

Europe's association with its former colonies has been an integral part of the discussion over trade policies since the start of the EU as the European Economic Community (EEC). The treaty of Rome in 1957 established preferential trade access both to Community members and developing countries of the ACP region (Hurt, 2012). A milestone in the process of this relationship was the 1975 agreement known as the Lome Convention which granted non-reciprocal trade preferences to 46 independent states. The growing importance of structural adjustment in the latter versions of Lome combined with the ideological hegemony of trade liberalization implied in the WTO paved the way for a paradigm shift with the Cotonou agreement in 2000.

For Faber & Orbie (2009) the post-Lome trade regimes share two characteristics. These include compatibility with WTO provisions and differentiation among members of the ACP region according to their economic structure and level of development. Acknowledging the challenges these pose, the WTO invoked a waiver for developing countries whereby non-reciprocal trade agreements could hold through the framework of the new EPAs. Such initiatives included the Generalized System of preferences (GSP) for countries “most in need” (EC, 2016) which was available since 1971 but has been modified to account for the different stage of economic development within the LDC group. Furthermore, the "Everything but Arms" (EBA) program grants duty-free and quote-free access for LDCs to all products excluding guns and ammunition.[19]

The Economic Partnership Agreements (EPAs) are bilateral trade agreements negotiated between the EU and six regional groups of ACP countries and seek to replace the previous non-reciprocal trade agreements which were not WTO compatible following the signing of the Cotonou Agreement in 2000.[20] The main novelty of the EPAs is that they include an array of reciprocal trade measures and aim to liberalize 90 percent of trade, in accordance with WTO (2000). In addition to trade liberalization, the new generation of agreements covers a broader agenda of measures that seeks “better” governance, “modernization” and integration of LDCs into the global economy (European Commission, 2013). As such, the EPAs go beyond simple tariff measures to include a wide set of policies ranging from investment policy bearing on FDI, competition policy and public procurement.

In addition, EPAs would seek to embody policies that promote particular environmental and labor standards, gender equality and integration of women in the real economy and comply with technology and safety standards according to the WTO (Open Europe, 2010). An extract from the recent EPA signed with the SADC serves to illustrate this (EC, 2016):

"The participants of the SADC EPA confirm that any new or modified legislation on labor conditions or environmental practices that they may adopt will follow internationally recognized standards. It means also that they cannot weaken labor or environmental protection to encourage trade or investment."

These behind-the-border policies embodied in the EPAs are commonly referred to as "Singapore issues" (Faber & Orbie, 2009) and are in line with developments in EU trade relations with emerging economies (India, South Korea and the ASEAN block) as part of the "Global EU" trade strategy. The "Singapore issues" imply a policy shift for the developing countries in line with the European Commission's (2014) communication that seeks "a stronger role for the private sector in achieving inclusive and sustainable growth for developing countries" and which supports the allocation of aid funds towards regulatory reform and private sector capacity building. Bilal (2007) sums up the four pillars upon which the EPAs are constructed as follows:

1. Development: The EPAs are negotiated with a view to the economic development and greater integration of the ACP countries

2. Reciprocity: ACP economies are to liberalize imports from the first time marking a significant shift from the previous trade agreements
3. Differentiation: The agreements give emphasis to the level of development within the ACP country group and allow for flexibility, special treatment and asymmetry
4. Regionalism: Despite some negotiations with individual countries, the EU aims to promote agreements in the regional level. Moreover, a contingent task of the EPAs is the promotion of regional integration and increases South-South cooperation.[21]

The six regional groups that negotiate with the EU are:

- Caribbean
- Central Africa
- East and Southern Africa
- Pacific
- South African Development Community
- West Africa

The negotiations have been taking place since 2002 at a regional as well at national level. The first region to sign an EPA was the Caribbean and the CARIFORUM-EU EPA was established in 2008. West Africa followed in 2014, and most recently an agreement was signed between the EU and SADC (June 2016). The agreement with the East African Community was supposed to be concluded mid-2016 but has suffered a setback with the refusal of Tanzania to endorse the agreement,[22] and the EU has concluded an EPA with Papua-New Guinea as an individual state from the Pacific group.[23] Finally, Brexit has created a new uncertainty regarding the EPAs that are yet to be signed or regarding the way in which the existing ones will be shaped in practice by the prospect of the UK leaving the EU and negotiating its trade and investment agreements directly with developing countries.

3.2.3.2 EPAs for or versus development?

The progress towards the EPAs has been presented as an important step towards fostering development and modernization for the ACP economies in alignment with the Sustainable Developmental Goals (SDGs). Article 1 of the Cotonou Agreement (2000) states that "The partnership shall be centered on the objective of reducing and eventually eradicating poverty consistent with the objectives of sustainable development and the gradual integration of the ACP countries in the world economy." Indeed, the Lisbon Treaty (2009) dictates that the success of the trade agreements will be measured by the degree of fulfilling the goals of poverty reduction and eradication. According to the EC's Agenda for Change (2012) "This calls for a rights-based approach, promoting in particular the right to universal and non-discriminatory access to basic services, participation in democratic political processes, transparency and accountability, justice and the rule of law, and with a focus on poor and vulnerable groups".

ACP countries are expected to benefit through access to European markets for their exports, better infrastructure funded by the AfD funding schemes and "more transparency, political [and] economic stability" (European Commission, EPA Factsheet). In addition, EPAs are to act as engine for development " by tagging on to ACP regional integration initiatives" (EC, 2013), boost regional markets and increase South-South cooperation. The EU offers a diversified approach for every region to address critical issues and ensure that these agreements go beyond the standard trade related measures and adhere to the developmental mandates. For example, in the EPA with West Africa "the EPA includes a variety of safeguards which can be deployed if imports of liberalized products are increasing too quickly thus jeopardizing local markets. Special protection is foreseen for infant industries, and the EPA allows West Africa to take specific measures in case food security is threatened" (EC, 2014). Finally, the idea is that manufacturing and high technology enterprises in LDCs would benefit from the reduced costs of liberalized imported inputs from the EU economies. The contradictions that may open up between the rhetoric and the practice of trade and investment liberalization, however, persistently seem to elude European policymakers. For instance, the EC supports "Aid for Trade (AfD)" disbursements (EC,

2013) under which enhanced development funding is designed to compensate for the potential short-term losses due to trade opening (especially to EU imports) but this is contingent upon trade-friendly reforms and policies. ((And, the Commission recognizes the need to allocate development funds towards the private sector of ACP countries to help businesses meet international standards but also directly through funding business advisory services.)) The EU itself further observes that the trade-related assistance on behalf of the EU "will not cover loss in customs duties or additional support for economic adjustment" (EC, 2008).

The policies that are embedded in the EPAs and that are projected as aimed at promoting growth in the ACP countries also seek to develop sizeable markets for EU exports and trade balance improvement. The new phase in trade relations indeed poses significant threats to the developing countries. The first issue of concern is that too rapid bilateral liberalization will have minimal effects for ACP exports, since many countries operate under preferential agreements, whereas the surge in imports from the EU will be sizeable thus deteriorating the trade balance (Open Europe, 2010). Faber & Orbie (2009) argue that the loss in tariff revenues will be substantial and asymmetrical as the importance of tariffs in total revenues varies significantly within the ACP group. The gap created in the revenue side of the economy will most likely lead to fiscal austerity that could hinder economic growth. Stevens & Kennan (2007) highlight the shrinking policy space for ACP governments brought upon by the trade and non-trade related implications of the EPA. Adherence to the neo-liberal policies of harmonization and deregulation may compromise the policies necessary to foster development.

Moreover, the goal of regional integration might be jeopardized by the nature of the EPAs themselves. Countries in the same EPA region have different policy objectives and can choose to liberalise different sectors according to their national interests. Unless a common liberalization strategy is agreed, then the individual actions of the regional partners will most likely increase trade barriers between them and impede the process of forming regional trade blocks along the EU vision. The Aid for Trade provision has met resistance from the ACP countries as it makes funds conditional on policies that could potentially create external imbalances and deter economic growth (Open Europe, 2010). Hurt (2012) points to a final caveat to successful implementation of the EPAs and promoting prosperity. This relates to the fact that negotiations were led by the Commission's DG Trade rather than the DG Development. This has caused tensions within the European Commission and confusion amongst ACP negotiators. In his view, the adjustment process towards the new trade and development paradigm will fall asymmetrically on the developing countries[24]. He concludes that EPAs represent the effort of the EU to "lock-in neoliberalism within ACP states" after failing to do so during the Doha Round of the WTO. In the same vein, Faber & Orbie (2009) recognize an ideological component in the EPAs, according to which economic orthodoxy and deep integration is to be "exported" to the developing world. Sylla et al. (2014) do not share the EU vision and argue that agriculture in Africa will be adversely affected creating an immigration wave both within the country but also to the developed world. In their attempt to debunk the myth of EPAs promoting investment the authors underscore that they only grant preferential treatment to investment from the EU, thus reducing choices for the host economies.

4 Matters arising

This synthesis report draws on research undertaken for Task 2 of Work Package 6, which was concerned in particular with assessing the implications of changes in the global financial and monetary system on developing countries. It highlighted the changing nature of the financial integration of developing countries and the particular policy paradigms promoted by the EU. This final section considers a set of issues that arise.

4. 1 Lop-sided financial integration and the imperative of domestic resource mobilisation

This synthesis report has highlighted that a fluid mix of financial resources flows to and from developing countries. The mix varies considerably across countries but there is a set of hazards attached to the accelerated financial integration of developing economies (see also UNCTAD 2015). These relate to the scale, volatility and costs of short-term flows with implications for the financing position of countries, their exchange rate, and their fiscal position when private debts become nationalised.

The liberalisation of capital accounts in developing countries resulted in increasing volatility of financial flows. This was highlighted during the 2008 crisis, when portfolio investment and financial flows immediately contracted. The crisis also demonstrated that MICs are more vulnerable to volatile international capital flows than LICs. Such volatility presents challenges for governments, mostly in relation to unpredictability of revenues and therefore spending.

The risks attached to accelerated international financial integration through the liberalisation of capital accounts and increased dependence on external finance raise the imperative of domestic resource mobilisation (DRM) and improvements thereof in developing countries. For most countries, DRM is the largest resource available to fund national development. A country's ability to mobilize domestic resources and spend them effectively—at the national, sub-national and municipal levels—lies at the crux of financing for development. Public investment is crucial to expanding domestic capital formation. When the share of public investment in total infrastructure investment falls, infrastructure investment as a share of GDP also falls (see Van Waeyenberge and Bargawi 2015).

Van Waeyenberge and Bargawi (2015) document that there have been strong improvements in domestic resource mobilisation efforts in the developing world over the last 15 years. While there are important variations across countries, tax to GDP ratios are above 15 percent in around half of all developing countries. There further remain important potential tax increases to be realised across all country income groups with significant implications for domestic resource mobilisation.

The origins of government revenues differ between countries, with resource-rich developing countries relying heavily on extractive industries. This exposes government revenues to vulnerability to volatile commodity prices. Further, many developing countries face narrow tax bases and lose significant resources as a result of illicit financial flows or as a result of tax exemptions (including those obtained through investment treaties). The European Development Report estimates that illicit financial flows amount to around $542 billion per year on average during the 2002-2011 period. Around 80 percent of these flows "are due to trade mis-invoicing, a practice which undermines government efforts to tax companies" (ODI 2015, p. 103).

Moreover, it is not only the level of taxation that matters, but also its structure, which has powerful effects on fairness. In this regard, the key trend is one of a continued increase in revenue collection through value-added tax (VAT), a continued decline in tariff revenues, and a continued weakness in personal income tax (World Bank and IMF 2015, paragraph 17). And while the progressivity of the tax system needs to be assessed in conjunction with the distributional impact of the spending it finances, it remains a concern "that the tax instrument that most directly addresses equity concerns remains underdeveloped".

Domestic resources can also be mobilized through domestic borrowing and there has been an increased trend in mobilizing through local bond markets, including at sub-sovereign levels. In this context, it could be noted that the general fiscal position of the developing world has improved substantially over the last 10 years, with fiscal deficits, after worsening as a result of the GFC, well within the conservative bounds (of -3 percent of GDP) (see Van Waeyenberge and Bargawi 2015). However, risks remain attached to global financial spillovers to emerging market sovereign bond markets when foreign participation in local bond markets is substantial (see Ebeke and Kyobe 2015).

In addition, the public debt situation in various countries has improved markedly, with public debt/GDP ratios at historically low levels. In this context, however, a concern arises with regard to the contingent liabilities that are created for the state through the rapid accumulation of private debt in developing countries, as the state is often drawn upon for bailouts through recapitalisation of banks in case of the latter's failures (Akyuz 2014, p. 64). Bova et al. (2016) construct the first comprehensive dataset of contingent liability materialisations. These encompass a range of contingent liabilities, including financial ones originating from sub-national governments, natural disasters, public private partnerships, legal cases, state owned enterprises and private enterprises. Financial sector related contingent liabilities have been a major burden on government finances (see also below).

Finally, apart from mobilisation through the tax system or through domestic borrowing, the state plays a role in domestic resource mobilisation with its capacity to mobilise domestic savings through such mechanisms as mandatory retirement programmes, pricing policies of state-owned enterprises or through strategic interventions in domestic financial institutions.

Mudrovna (2015) discusses efforts in EMDEs at DRM for industrial development through a closer look at four case studies. First, the case of Brazil illustrates that despite the existence of a large and relatively effective disbursement institution, through the national development bank, BNDES, the country faces challenges in the form of misaligned policy instruments. Therefore, not only the volume of available funding but also the incorporation of funding into wider industrial strategies matter for successful self-financing mechanisms.

The second vehicle for accumulating domestic resources examined is pension funds. In South Africa and Brazil, private savings administered by public pension funds represent two of the world's most dynamic pension fund industries. However, due to the financialisation of the global pension fund market, the aims of the funds have shifted towards maximising profits of their assets, away from supporting domestic socio-economic objectives. Pension funds are increasingly seen as sources of liquidity able to channel resources towards a great variety of assets. While Brazilian pension funds still serve as instruments for enhancing broader economic objectives, their South African counterparts are governed by profits only. The purpose of Brazil's PREVI, PETROS and FUNCEF's participation in the privatisation process of the 1990s was to maximise the benefits of privatisation by dividing the profits among their members. On the contrary, South Africa's GEPF invests in the most profitable sectors in the country, without any specific concern for public goods. Its investment is skewed towards finance, mining and property, reproducing historical patterns of underinvestment in South African productive sectors. The challenge arising from the comparison between the South African and Brazilian pension systems is therefore how to combine effective management of resources with their allocation for the purpose of increasing productive growth.

The third self-financing mechanism discussed relates to export strategies pursued by many emerging and developing countries. The case of India demonstrates that it is not just industrial strategy that drives successful development, but also the ability of a country to retain foreign exchange acquired through export earnings. India's development strategy envisaged using exports of ICT software to attain resources for financing the development of higher value-added hardware industry. However, because of power struggles between government agents and foreign and domestic producers, the retention of foreign exchange from exports never materialised. On the contrary, the export of software made the industry more dependent on the export of low value-added software services, which in addition requires subsequent import of foreign hardware and software, worsening India's trade balance. The government's inability to harness export revenue reproduces its bias towards software, contributing to locking in India's hardware industry in low value-added assembly of foreign computers.

Last, in comparison with India's inadequate foreign retention mechanism, the case study of China demonstrated how the evolution of Chinese capital controls contributed to the retention of a large proportion of China's export earnings and their subsequent use for financing of industrial development. Changes in China's policy from a dual exchange rate mechanism to the current monetary policy administered by the People's Bank of China were looked at. The analysis also explored the institutional vehicles deployed for allocating foreign exchange reserves. For the purpose of investment in domestic markets, the reserves are used in two ways. First, since the early 2000s the reserves have been used for recapitalising large development banks in order to improve their performance. This happened in the case of the Agricultural Bank of China and the China Development Bank. Secondly, the reserves are used to improve economic performance through financing industrial upgrading. The China Development Bank (CDB) and the Exim Bank are two main channels for financing

Chinese companies' industrial expansion. The institutions are instruments supporting the government's commitment to the promotion of renewable energy. This was demonstrated in the case of the wind turbine manufacturing sector discussed in Mudrovna (2015). The unprecedented growth of the wind energy sector in China and its subsequent globalisation would not have been possible without financial assistance provided by both the CDB and Exim Bank.

The main lesson arising from the four case studies of DRM was that successful industrial strategy does not depend only on the ability of the state to mobilise finance but also on its allocation towards productive sectors of the economy and hence the mobilisation of domestic resources in the service of a broader industrial policy strategy.

4. 2 The persistent promotion of financial sector development: for what purpose?

A growing part of EU aid has been directed at the promotion of the development of the financial sector in developing countries. Bonizzi et al (2015) emphasise that while academic debates on the finance-development nexus have long raised concerns, the policy proposals have hardly changed, with a strong focus remaining on financial development as a prerequisite for inclusive and balanced growth.

The broader interest prompted by financialisation and the GFC has, however, spurred a set of questions being asked once again about the nature and purpose of financial systems. What types of activities should our financial systems foster? How large should they be? Who should control the institutions of our financial systems? Who benefits from the expansion of the financial sector? Etc. A recent IMF Staff Discussion Note (Sahay et al. 2015, pp. 5-6) put this as follows:

> The 2008 global financial crisis raised some legitimate questions about financial deepening and financial development, given that the crisis originated in advanced economies, where the financial sector had grown both very large and very complex. Are there limits to financial development for growth and stability? Is there a right pace of development? Are there tradeoffs? What is the

> role of institutions in promoting a safe financial system … Does financial integration help or hurt economies?

These questions set the scene in Sahay et al. (2015) for a review of the evidence that has emerged over the last few years on the relationship between financial development and growth.

The IMF Discussion Note (Sahay et al. 2015) proposes a new, more comprehensive indicator of financial development, the Financial Development index, to replace the ratio of private credit to GDP (sometimes augmented with stock market capitalization as a ratio of GDP), which has traditionally served as a measure of financial development. It is argued that the traditional indicators do not capture sufficiently well the various ways in which financial development can affect growth,[25] as they fail to capture the diversity of financial systems across countries. The new measure (index) incorporates multiple indicators of financial development, including measures of financial depth, access and efficiency of financial institutions and markets (see Annex I of Sahay et al. 2015 on how the index is constructed). The index also reflects the reality that financial sectors have evolved over time to become complex systems that include a range of financial institutions (banks, investment banks, insurance companies, mutual funds, pension funds, venture capital firms and other nonbank financial institutions) and financial markets (including stock markets, private and public bond markets and foreign exchange markets).

Deploying this new index Sahay et al. (2015) propose the following findings. There is a positive relationship between financial development and growth (and stability). But, this relationship has a bell-like shape, i.e. there are trade-offs between financial development and growth and stability where at some point the costs outweigh the benefits. "In fact, there can be instances where there is 'too much finance'" (p. 6). Further, the pace of financial development matters, where too fast a pace can cause instability. And, strong regulation and supervision of the financial sector is a condition for financial development to lead to growth rather than instability. Finally, "there is no one particular point of 'too much finance' that holds for all countries at all times" (p. 15). The shape and location of the bell-like curve depicting the relationship between finance and growth differs between countries and is affected by features such as income levels, institutional environment, regulatory and supervisory quality within the country, etc. It can easily be conceived that in lower income countries the point at which there would be too much finance will be reached faster than in higher income countries.

These findings follow on from earlier contributions, which had illustrated how the traditionally projected positive link between financial development and growth weakens when using post-1990 data. Barajas, Chami, and Yousefi (2013) highlight that the relationship between financial development and growth differs across regions, countries and income levels. Rousseau and Wachtel (2011) point to the increased incidence of banking crises in accounting for the absence (or "disappearance") of an empirical link between finance and growth. And Arcand, Berkes, and Panizza (2012) illustrate how there may be a point at which additional deepening start harming growth (the "too much finance" –effect).[26]

Different accounts have been provided for the weakening of the finance-growth relationship. Cecchetti and Kharroubi (2015) point to negative effects on allocative efficiency and crowding out of human capital away from real sectors towards the financial sector, as the latter expands rapidly. Dabla-Norris et al. (2015) suggest that resources in advanced economies had been diverted away from productive sectors toward the financial sector in the period prior to the global financial crisis. Rajan (2005) draws attention to the scope for "catastrophic meltdown" when financial development leads to large and complicated financial systems.

Most recently, the OECD in a Report entitled "Finance and Inclusive Growth" (Hoeller, Denk, and Cournède 2015) has added its voice to demands for cautious assessments of rapid financial expansion. The Report argues, on the basis of an analysis of data spanning 50 years, that too much finance may hamper economic growth and may worsen income inequality.

Yet, despite these various observations, the World Bank (2013, p. 32), for instance, in setting out its vision of Financing for Development post-2015 has persisted with the proposition that:

> Promoting financial deepening and inclusion could accelerate private-sector growth, an important driver for poverty reduction and fostering shared prosperity. Financial institutions facilitate economic growth by mobilizing savings and allocating these savings to the most productive investments. There exists a large body of evidence finding a strong, positive relationship between financial sector development and growth. A well-developed and inclusive financial system also has positive impacts on equality by providing poorer individuals with savings opportunities and much-needed credit. Without inclusive financial systems, poor people must rely on their own limited savings to invest in their education or become entrepreneurs—and small enterprises must rely on their limited earnings to pursue promising growth opportunities. This can contribute to persistent income inequality and slower economic growth.

Different policy directions clearly prevail across the world of international financial organisations and think tanks, where this quote from the World Bank indicates a persistent unwillingness to question previously held ideas regarding financial development and growth. The World Bank persists with an understanding of hurdles to growth and development entirely anchored in insufficient (private sector) financial development. A singular focus on lack of financial inclusion (i.e. broad access to financial services within the population) as cause of income inequality and slow economic growth transpires to the neglect of the broad set of non-financial factors, actors, institutions and linkages that bear on development outcomes.

It was documented above how the EU's approach to development cooperation shares such an outlook of finance as a benign force and conduit for development. Financial sector development remains core to the EU's development cooperation. This is reflected through the specific sectoral allocation of its ODA flows; the particular policy advice on financial sector development it promotes; and the way in which the blending initiatives are disbursing flows.

Fast expansion of financial sector (as promoted by EU and other donors) nevertheless raises strong concerns regarding the effectiveness of the financial sector in fostering growth and development. It was illustrated above, for instance, how within the Franc Zone rapid credit growth has taken place as a result of various policies to promote credit expansion. It remains uncertain, however, whether this credit growth has been instrumental in financing structural transformation (see Griffith Jones and Karwowski 2013). This raises the issues of finance for whom and for what purpose and regarding what kind of regulatory oversight is being exercised as financial sector expansion proceeds.

It was also pointed out above how a large part of the funds entrusted to the Investment Facility (EDF) under the Cotonou agreement is allocated to financial sector development. The IF is managed by the EIB and seeks to support private sector development in ACP states. The EIB makes frequent use of financial intermediaries to on-lend to SMEs. Bonizzi et al (2015, p. 22) observe that "this practice lacks transparency, as the ultimate use and beneficiaries of the loans are unknown. Assessing social, environmental or economic impacts of the EIB loans to the financial sector is very difficult. The EIB works with standard commercial financial intermediaries who have no attachment or tie to fulfilling development outcomes. The EIB's loans are actively facilitating the commercial banking sector or other types of intermediaries such as private equity funds (Counterbalance 2013)." See also Eurodad (2013) which raises concerns regarding whether intended beneficiaries are actually reached through the Facility and whether the Facility is an appropriate tool to provide access to finance for SMEs.

Further, a crucial issue is the contingent liabilities that result from financial sector promotion. There needs to be much more explicit attention for the risks to public finance that may result from financial deepening and integration. Bonizzi et al (2015) highlight that the prospect of the public sector in developing and developed countries taking on liabilities of the private sector when the latter can no longer meet these is particularly real for the banking sector. They add that this raises significant concerns regarding possible debt implications for developing countries when loans to the financial sector increase. In a recent IMF study, Bova et al. (2016) document how financial sector related contingent liability realisations have often been a major burden on government finance.

Finally, some tension has emerged as a result of the imperative of financial sector development versus traditionally more hostile attitudes towards public sector borrowing (dominated by concerns of crowding out). The case of the Franc Zone discussed above served to illustrate the attention that the development of markets for government securities now receives in efforts to develop local financial markets. The focus seems to have shifted towards a preoccupation with the way in which marketable government debt facilitates the emergence of private debt markets, rather than with prudential measures of public finance. Laskaridis and Toporowski (2015, p. 2) observe how this "marks a shift in rhetoric about government financing - from negative due to crowding out arguments to more favourable views because the provision of good collateral is supposed to promote domestic financial deepening". The change in attitude towards government borrowing in the Franc Zone is traced to the transition in the literature from stagnation and debt burdened crisis of the 80s and 90s to the presentation of "lucrative debt markets" for global investors searching for yields.

4.3 The private turn in development cooperation: hazards and pitfalls

The private turn in European aid raises a set of issues. These include concerns regarding the dilution of ODA, aid tying, additionality, transparency and accountability, ownership, and the implications of the increased involvement of the private sector in public service provisioining. We briefly consider each of these.

4.3.1 The dilution of ODA

The GFC has had negative implications for the willingness of Northern donors to finance development assistance. This is evident in their lackluster performance in terms of ODA/GNI ratios. The latter has been on a declining trend since 2010 and stands at an average of 0.29 percent of GNI in 2014. This remains far away from the committed target of 0.7 percent and below shares observed in the early 1990s. The limited fiscal capacity (and political willingness) of Northern donors to fund ODA is likely to persist for the coming years, as Northern countries frequently invoke budgetary constraints at home and changes in the global financial landscape.

Accompanying these trends there has been a redefinition of the purpose of ODA and development cooperation more broadly. This has been driven by the weakening of Northern donors' commitment to the public financing of development. A strong belief and commitment to the potential of private flows has come to prevail. The fast expansion of private flows since the early 2000s has indeed often been the result of specific policies enacted by Northern donor countries (or financial institutions) – in particular capital account opening and liberalisation of domestic financial systems. And when Northern aid picked up again in the early part of the 2000s, this reinvigoration was characterised by a distinct understanding of the role of aid: in support of private flows as the main source of development finance. This had specific implications pertaining to the increasing prominence of new instruments of aid, in particular through various "blending" mechanisms, including the widespread promotion of PPPs. As ODA becomes increasingly deployed to mobilize private finance for development, the core role of public finance for public goods is downplayed. This trend has accelerated as a result of the implications of the GFC for fiscal space to support ODA in developed economies.

For Eurodad (2013, p. 8): "blending could be seen as part of a potential sea change for development finance, which effectively shifts ODA from the public to the private sector, while at the same time helping to replace ODA with private finance".

The shift towards the private turn in European development cooperation then needs to be understood against the backdrop of the negative implications of the GFC for development assistance. In 2012, aid from the EU (and member countries) represented only 0.39 percent of EU's GNI (down from 0. 44 percent in 2010), bringing this back to its lowest level since 2007, when aid represented 0.37 percent of EU's national income. In 2012, the EU countries delivered €50.6 billion in ODA, which represented a 4 percent drop as compared to the previous year.[27] Aid has either been cut or has remained stagnant in 19 EU member states. The deepest cuts between 2011 and 2012 took place in Spain (49 percent), Italy (34 percent), Cyprus (26 percent), Greece (17 percent) and Belgium (11 percent) (CONCORD 2013, p. 5). CONCORD (2013,

p. 8) adds that while most EU member states have confirmed their intention to honour the commitment to achieve the 0.7 percent ODA/GNI ratio, it remains unclear how they will achieve this. Yet, while making less resources available for development cooperation, donors wish to make these resources work harder.

4.3.2 The spectre of aid tying

Apart from the declining willingness to fund development cooperation publicly, blending may worsen the prospects regarding aid tying. EU blending facilities have broad stated objectives such as (quoted in ODI 2011, p. 26): "Promoting equitable socio economic development and job creation through the support for small and medium size enterprise and the social sector", and "To provide greater coherence and better coordination among the donors". ODI (2011), however, adds that most facilities also include "supporting EU linked businesses as a priority" which is in contradiction to the EU member states' commitment on untied aid. The OECD (2015, p. 32) has highlighted the danger of blurring the lines between the activities of export credit agencies and DFIs "when bilateral DFIs mainly support their domestic enterprises with credits and guarantees" through various blending arrangements. When blending operations involve large multinational companies of EU member states (as was the case in the example provided above), the issue of tied aid looms large. For Eurodad (2013, p. 4) the EU's blending agenda is seen as a "convenient excuse for donors to give less ODA, and it provides an opportunity for rich countries to support their own domestic companies".

4.3.3 Additionality

The question of additionality has been raised across the literature. The main concern with additionality is whether the publicly backed resources are necessary to make private investment happen (as they would otherwise crowd out or displace private resources and as such distort "optimal" allocations of private finance), and whether the development impact of privately financed projects is enhanced as a result of the blending mechanism. The former is referred to as financial additionality while development additionality captures the latter effect (UKAN 2015, p. 4). UKAN (2015) reviews the existing literature that assesses the additionality of ODA in leveraging private investment. It delivers a negative assessment in that it finds very little evidence about the financial or developmental additionality of leveraging private investments. Further, it highlights that there are no shared or common methodologies across donor agencies to measure additionality. Moreover, the Report highlights that research points to the difficulty in aligning leveraging of private investment with aid effectiveness principles (see also Griffiths 2015). Eurodad (2013, p. 13) adds that while poverty reduction and sustainable development are often part of the objectives of EU blending facilities, "not all institutions involved in the existing blending facilities have a common and agreed development mandate". Against this backdrop, the European Parliament has passed a resolution (in June 2013)[28] calling for better evaluations of the mechanism of blending loans and grants – "particularly in terms of development and financial additionality, transparency and accountability, local ownership and debt risk – before continuing to develop blending loans and grants" (Griffiths et al. 2014; see also Vervynckt 2014; Eurodad 2013; Concord 2013; Martin 2015).[29]

Further, the question arises as to who is leveraging whom. Van Waeyenberge (2015) documents how in the case of a Senegalese toll road, the private sector successfully leveraged the public sector rather than the other way round. A toll road was built allowing a French MNC to collect tolls from road-users in Senegal for the next 25 years, with the financing for the toll road having come from various development institutions, crowding in (rather than leveraging) a relatively small amount of private finance, to a ratio of nearly 5:1 (public to private contribution). This is a clear demonstration of the private sector leveraging the public sector and turns the principle of leveraging upside down.

Finally, while blending is projected as part of a more differentiated approach to development cooperation, which would allow to concentrate ODA in LICs and perhaps use blended facilities in MICs, currently, blending facilities straddle all developing countries, i.e. they are not targeted to a particular income group. It is not clear further whether, if blending facilities would be focused on MICs, public resources (provided through the facilities) are needed to draw in private capital (for large infrastructure projects). Do these projects need a public subsidy or could the limited public resources not be put to better use (see also Eurodad 2015)?

4.3.4 Accountability and transparency

Blending raises issues of accountability and transparency. Eurodad (2013, p. 16) has criticised the low levels of information publicly available on the leveraging activities going on in the EU, both through the EC's own facilities and member states' DFIs. The report observes that: "[i]t is not possible to do a proper portfolio analysis of the projects supported by blended ODA, as the EC does not track or evaluate the commercial loans that ODA grants are blended with, nor estimate the extent to which the grants proved essential to attracting the loan". The lack of transparency may imply that common channels of oversight such as e.g. through parliamentary scrutiny, fail to operate in the absence of adequate information.

4.3.5 Ownership

The issue of ownership to which donors are officially committed could be particularly fraught in the context of the blending facilities. The process through which projects get selected and pursued originates with the EU DFIs, where the selection process proceeds on the basis of financial criteria (European Court of Auditors 2014, p. 9) rather than that the project pipeline is designed in collaboration with partner governments and informed by their own national development plans. This also means that financial criteria prevail over social objectives in the design and implementation of the provision of core public services such as infrastructure facilities. We may want to recall that when development cooperation targeted such interventions in the past, this traditionally proceeded through grants or concessional loans, which allow for the incorporation of a broader set of criteria when designing a system of infrastructure provisioning. Crucial is the possibility for the deployment of social objectives to ensure access and equity in the use of a specific infrastructure facility. Yet, the increased involvement of DFIs has significant qualitative implications, both for ownership and governance of infrastructure or other public services (see Eurodad 2013). Eurodad (2013) has also raised concerns that the mechanisms for civil society participation or consultation during the implementation of the projects are often ad hoc if possibly non-existent. The same lack of institutional mechanisms of accountability applies in the context of complaints of (and redress for) communities affected by a large project financed through a blending facility.

4.3.6 Private sector involvement in public service provisioning

Finally, there are a set of issues that arise from the increased promotion and involvement of private sector agents in areas that were previously understood to be the main preserve of the public sector. This includes equity considerations, cost considerations, implications for fiscal sustainability, and more general issues of income redistribution that may result from the increased involvement of private sector agents in the provision of essential services. Van Waeyenberge (2015) carefully unpicks these and concludes that while the involvement of the private sector implies a complex web of public (financial and non-financial) support for such involvement, it remains unclear what the public or collective benefits are from increasingly complex mechanisms of public-private interactions. The private sector tends to carry little risks (financial or/and operational) for the rewards it reaps. Actionaid, Eurodad, and Oxfam (2014, p. 1) draw attention to the implications this has for the deployment of public development assistance to promote private sector involvement in developing countries: "Lack of transparency around aid to the private sector, and particularly around the building and leveraging strategies makes it hard to evaluate the amount of money given to the private sector and its impact". The rationale for increasing the role of the private sector in development should be to make a contribution to poverty eradication and achieve sustainable development rather than to help private firms make a profit.

In particular, the assumptions regarding private sector firms' behaviour that govern the turn towards blended finance need further attention. It is not clear which analytical arguments are deployed to support the strong bias in favour of private sector interventions in fields that were traditionally understood to require direct state intervention (such as typically infrastructure provision). It seems that while the Washington Consensus was attached to a notion of perfect working markets (except in the case of readily identifiable market failures such as the existence of externalities, large sunk costs (natural monopolies) or public goods) and the post-Washington Consensus broadened the scope of market failures, positing a paradigm of imperfect working markets, there is currently no clearly identifiable set of analytical proposition which can account for the prevailing preference for private sector provision in sectors traditionally calling for extensive state intervention. The superiority of the private sector over public service provisioning seems to have acquired canonical status (see Carter 2015 for a recent example). The mantra of superior performance of the private sector has combined with arguments of scarcity of resources to finance public investment, against a backdrop of plenty of private wealth. So, rather than devise better taxation coordination policies internationally to enable public mobilisation of resources for investment, the logic turns to the private mass of wealth as a resource for development. But as development is a risky enterprise, the public sector needs to enable the private sector's appetite for it. This necessitates both indirect interventions through changes in the investment climate favouring private investment and direct interventions through subsidies, guarantees, and various other risk-mitigation instruments.

We then are in urgent need of a mapping of the way in which publicly-backed resources, or aid, assist the expansion of private (often foreign) capital in particular markets/sectors in developing countries and to what effect. What are the implications for access to the service, at what cost, what is the equity impact, what are the broader implications for fiscal mobilisation by the recipient state, etc. This needs to be done in order to assess whether the criteria the European Commission (2014b, Box 1) has put forward to support private sector actors are useful.

[1] Note that Akyuz (2014, p. 17) draws attention to the potentially arbitrary nature of the division between FDI and portfolio equity. For a flow be classified as FDI implies the acquisition of at least 10 percent of

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voting stock in a new or existing firm, with ownership below 10 percent treated as portfolio equity. "Ownership of 10 per cent or more is seen to imply the existence of a long-term, stable relationship between the investor and the enterprise and a significant degree of influence on management (IMF 2009)". However, Akyuz (2014, p. 17) contends that "there is no compelling reason why investment in 10 percent ownership or more should be less fickle than in 9.9 percent".

[2] This breaks down as follows: average annual FDI at US$ 274.1, average annual net banking lending at US$ 403.1, annual average portfolio flows at US$ 40.9.

[3] Asia accounted for 31 percent of global outward FDI in 2012, with this being primarily driven by China.

[4] Bonizzi et al. (2014) provide a detailed breakdown of how the profile of external indebtedness differs across different income categories of countries. The rise of private sector external commercial indebtedness is particularly the case for upper middle income countries, and has occurred to a lesser extent in lower Middle Income Countries (MICs) where private sector external debt grew very fast from 2002 onwards, but where this was mimicked by fast public external debt growth from 2005 onwards. For Low Income Countries (LICs) private non-guaranteed debt remains close to zero. Maturity structure of external debt also varies according to income category, with LICs having lowest proportion of external debt with short term maturities (standing at around 10 percent since 1972), while for lower MICs, this remained around 15 percent until 2005, after which there was a rapid rise of short term debt. For upper MIC, an increasing proportion of external debt has been of a short-term nature, rising rapidly since 2001, to reach over 30 percent in 2012. For LIC, 50 percent of their debt is multilateral and around 70 percent on concessional terms.

[5] See also Aizenman and Lee (2005) and Choi et al. (2007) for evidence on the strong correlation between capital account liberalisation and reserve holding and the tendency to absorb capital inflows into reserves rather than use them for current payments (Akyuz 2014).

[6] Note the role that the SWFs played in rescuing the financial crisis during the 2007-2008 financial meltdown, where between March 2007 and June 2008 these funds injected US$ 59 billion into Western financial institutions, including Barclays and Citigroup (Pitelis and Pitelis 2015, p. 13).

[7] But note that most of EU members' inwards FDI is intra-EU. The global financial crisis and Eurozone crisis have had an important impact on intra-EU direct investment, accounting for most of the declines in EU inward FDI. The decline also reflects a trend "towards registering ownership of multinational corporations in off-shore financial centres, rather than within European fiscal jurisdictions" (Bonizzi and Toporowski 2015, p. 14).

[8] The Consensus was followed by a Code of Conduct on Complementarity and Division of Labour two years later.

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[9] Specifically, paragraph 119 of the Consensus asserted that: "The EIB is playing an increasingly important role in the implementation of Community aid, through investment in private and public enterprises in developing countries".

[10] See http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupID=2852

[11] Own resources of the EC include: agricultural duties and sugar levies; customs duties and a uniform percentage rate to the VAT base of each member state (around 0.5 percent) (Gavas 2010). The EU budgetary aid allocation is determined through the 7-year Multi-Annual Financing Framework (MFF), which was approved by the European Parliament in December 2013 for the next 7-year period (2014-2020) and amounts to €51.4 billion (European Commission 2014, p. 6).

[12] The EDF is the EU's main instrument for providing development aid to African, Caribbean and Pacific (ACP) countries and to Overseas Countries and Territories (OCTs). It is financed by direct contributions from EU member countries and covered by its own financial rules. The total resources of the 11th EDF amounts to €30.5 billion for the period 2014-2020.There is an on-going debate on bringing the EDF funds within the MFF framework, but a decision on this issue has been postponed until 2020. Given that the EDF relies on voluntary contributions by member states and does not draw on the general EU budget, it is controlled directly by the European Commission and not subject to parliamentary oversight. Eurodad (2013, p. 9) argues that it hence has less accountability than the regular EC development budget.

[13] In this context, the crisis in Europe has raised concerns regarding how it could affect developing countries that peg to the Euro. Laskaridis and Toporowski (2015, p. 8) observe how "the European crisis brings to the fore much broader concerns such as the costs of maintaining a currency union. This has largely delegitimised the rosy picture of integration that dotted the literature on financial and regional integration".

[14] Between 2003 and 2013, the Facility has invested €3.4 billion, 85 percent of which in the private sector in ACP and OCT. The Facility's investments take the form either of risk-bearing (non-guaranteed) loans to the private sector or interest-rate subsidies. The Facility has been designed as a renewable fund, with the aim of deploying loan repayments for reinvestment in other operations (ibid.).

[15] It is followed by the energy sector – electricity and coal (European Commission 2013b, p. 61).

[16] http://www.efcanet.org/Portals/EFCA/EFCA%20files/PDF/28-06-07InformationExternalMandates.pdf

[17] Various definitions of "leveraging" abound. UKAN (2015, p. 17) formally defines it as "the use of public finance and risk mitigation instruments to remove the barriers to private sector investment in developing countries and thereby mobilse significant amounts of private capital for development". See also ODI (2011), Griffiths (2012) and Martin (2015) for discussions of the meaning of "leveraging" or "blending" in donor discourse and of how it relates to ODA.

[18] ODI (2011, p. 21) clarify that "As a general rule, all European development finance institutions are eligible to participate in blending facilities. Non-EU development banks, notably regional development banks and the World Bank, can co-finance projects already supported by the European DFIs and blending facilities. However, development finance institutions like PROPARCO and FMO, which focus solely on the private sector, can only participate alongside a European DFI. Beneficiary governments provide substantial co- financing but the position on non-EU private financing is unclear."

[19] For details on GSP and EBA access http://ec.europa.eu/trade/policy/countries-and-regions/development/generalised-scheme-of-preferences/index_en.htm

[20] According to Article XXIV of the GATT, a free-trade area (FTA) can exist as long as "substantially all" trade between EU and the partner regions is liberalized. In practice, this implies 90% of trade to be liberalized in an asymmetric way if necessary, for example 95% - 85%.

[21] See also Bilal (2007) on the role of regional integration in the EPAs. Regional integration was emphasized as early as 1996 with the EC's "Green Paper", prior to the Cotonou Agreement and the formulation of EPAs.

[22] http://www.newtimes.co.rw/section/article/2016-07-18/201805/

[23] Note that Mauritius, Seychelles, Zimbabwe and Madagascar have had an EPA in place since 2009.

[24] In his paper, Hurt (2012) emphasizes on SADC

[2525] Following Levine (2004) these include: producing information; allocating capital to productive uses; monitoring investments and exerting corporate control; facilitating trading, diversification and management of risk: mobilising savings; and easing the exchange of goods and services. See also Beck (2013) in Te Velde et al. (2013) for a summary of the various positive effects that the literature has highlighted in the relationship between finance and growth.

[26] See also Aizenman, Jinjarak, and Park (2015) on non-linearities in the finance-growth relationship and heterogenous effects across sectors.

[27] Note that although the EU states decreased their aid expenditure during the crisis, the EU institutions' ODA which is partially funded from resources independent of member states' contributions increased between 2011 and 2012 (Bonizzi et al 2015, p. 13).

[28] This followed an earlier resolution (23 October 2012) that called on the Commission to "provide clear information on how [the blending] mechanism serves the purpose of a development policy based on ODA criteria and how the power of scrutiny of Parliament will be exercised" (Eurodad 2013, p. 8).

[29] Concord (2013b, p. 5) in its analysis of EDF11 insists that "the EC has not proposed any clear objectives, principles, criteria and guidelines so far to ensure that this funding modality will truly contribute to sustainable and inclusive development and the eradication of poverty in ACP countries."

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THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?'

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