# ACFID Submission to the Development Finance Review

The Australian Council for International Development (ACFID) is pleased to provide this submission to the DFAT-led review of Development Finance. This submission has been developed by ACFID and its members, through the ACFID Development Finance Working Group, and with consultation with external experts and stakeholders.

## Executive Summary

We welcome the Australian Government exploring new forms of development finance. Given the rising development needs in our region and the widening financing gap, Australia must use all forms of development finance to invest in human development, deliver on our commitment to the 2030 Agenda, and support a clean energy transition in the Indo-Pacific region. Moreover, there must be strategic coherence between financing instruments. We emphasise the distinction between the two categories of finance: sovereign (e.g. loans to country governments) and non-sovereign (e.g. impact investing and other modalities like bonds and guarantees that attract private sector investment).

Innovative financing modalities should serve as a complement to an increased ODA budget, and work to advance the overarching objectives of Australia's international development strategy (that is, poverty alleviation and human development in line with the SDGs). As experienced and knowledgeable development actors, NGOs have an important role to play in ensuring that development finance achieves development impact, and that this work is led by and strengthens local institutions and organisations.

**SUMMARY OF RECOMMENDATIONS**

**All forms of finance:**

<u>Recommendation 1:</u> Ensure **development outcomes are the primary objectives** of any development financing, ensure alignment with the objectives of the new development strategy, and institute strong accountability mechanisms to ensure development impact and effectiveness is prioritised.

> <u>Metric</u>: Adopt a whole-of-government 'do no harm' and rights-based approach to investments in our region, which ensures any Australian government overseas expenditure or investment is aligned with the SDGs and meets all safeguards required.
> <u>Metric</u>: dedicated screening for development impact ahead of investment decisions.
> <u>Metric</u>: Consolidate Australia's use of blended finance in line with the OECD principles (especially Principle 1) and ensure all financing meets the additionality test and good practice standards.

<u>Recommendation 2:</u> Establish a **comprehensive platform for harnessing philanthropic investment** in development, building ties with philanthropic organisations and foundations and leveraging their interests and capabilities to support the government's objectives.

> <u>Metric</u>: Establish an entity like Canada's Forum for Impact Investment and Development (CAFIID) co-chaired by DFAT, the Australian Forum for Impact Investment and Development. This would be a platform for government, investors, NGOs and philanthropic organisations to coordinate activities. ACFID could assist.
> <u>Metric</u>: Unlock philanthropic funding by establishing an outcome fund (funded via grants) for the government to invest alongside philanthropic foundations.
> <u>Metric</u>: Work with WOG partners to ensure legislative clarity to help unlock funds held in endowments. Providing guidance so that managers/trustees of endowments take a less conservative approach to investing.

<u>Recommendation 3:</u> **Grants remain essential**. Deliver an ODA budget framework aligned to the new development policy which includes legislated, stepped targets for achieving the 0.7 per cent ODA of GNI by 2030 target that Australia has agreed to as a signatory to the SDGs.

Metric: A legislated commitment to reach 0.5 per cent ODA of GNI by FY25-26, and 0.7 percent by FY-29-30.

Recommendation 4: **Ensure the transparency and accountability** of Australia's development financing by making information about investment decisions, implementation, and results publicly available. Ensure there is independent oversight and an impartial and effective complaints mechanism for all activities.

Metric: Reporting should include ODA and non-ODA finance both through the budget papers and more regular public reporting.

Non-Sovereign Finance:

Recommendation 5: **Do not expand Export Finance Australia's role** in financing development projects. Deliver all development financing under a strong institutional mandate to promote inclusive and sustainable development, with expertise and governance arrangements to match. (See Recommendation 6)

Recommendation 6: **Consolidate all development financing instruments** in either an internal DFAT division or a standalone institution that has the expertise and a clear mandate to promote development objectives through innovative financing modalities. (See box on Establishing a DFI)

Metric: Develop and implement a strategic framework and theory of change for ensuring development financing maximises development impact, including a unified MEL framework, and a plan to build out the necessary skills, capability and risk calculus.

Recommendation 7: **Strengthen DFAT's initial good work on leveraging investment towards gender equality**. DFAT initiatives like Investing in Women and EMIFF take a strong approach to gender equity. We ask that DFAT continue to ensure all its investment mechanisms apply a gender lens.

Metric: DFAT formally participate in the 2X collaborative on gender lens investing.

Metric: AIFFP also works more towards gender equality

Recommendation 8: **Leverage the expertise of NGOs** as important partners in development financing activities. Enable the range of roles that NGOs can play as investors, intermediaries, technical assistance providers.

Metric: Invest in new funding models: fund a series of Development Impact Bonds

Metric: Unlock investment capital. Establish a blended finance mechanism for foundations and investment funds to invest alongside the government in development initiatives (application of grants and debts, could be extended to guarantees and equity)

Metric: Create an investment window in the Emerging Markets Impact Investment Fund (EMIIF) of $50 million for NGO-led impact investment funds and $50 million for clean energy transitions, climate finance.

Metric: Utilise NGOs as social impact technical assistance providers to conduct pre-investment assessments and verify social impact of investments.

Metric: Support the upskilling of NGOs (in Australia and our partner counties), including access to training, events and workshops, to equip them to deliver monitoring of programs for development impact.

Recommendation 9: **Address barriers to NGOs operating** as actors in the development financing landscape

Metric: Proactive endorsement of NGOs acting in this space with ACNC guidance note.

Metric: Provide a funding mechanism to assist NGOs in making the transition from grant-based funding models to impact investment models.

Metric: Coordinate with WOG partners (e.g. ATO) to help secure provision of concessional tax treatment for investments made in impact investment funds.

Sovereign Finance:

Recommendation 10: Ensure our loans **do not add to debt distress and do achieve development outcomes**.

Metric: Where aid is provided as loans or other debt instruments, these should be: highly concessional, never provided to countries at moderate or high risk of debt distress; and only used where the initiative to be financed reflects the priorities of the recipient country and has a clear development and poverty-alleviation benefit.

Recommendation 11: Australia should **work with G20 and OECD countries to strengthen global debt architecture** and provide stronger options for debt relief and restructuring.

Recommendation 12: Urgently undertake an **independent review of the AIFFP**. No expansion of the AIFFP should be considered (including the proposed Climate Infrastructure Window) until this review has been carried out.

> Metric: Accelerate the Auditor General's report into AIFFP. The review should assess the effectiveness of the AIFFP in realising development benefits and meeting the needs of partners across the Pacific region.

Recommendation 13: Reform development financing modalities to **meet our climate finance fair share**.

> Metric: Increase our climate finance to $3 billion for 2020-2025, alongside a clear plan to achieve a fair share of the USD 100 billion goal by 2025 - determined as $4 billion annually.
> Metric: Ensure Australia's climate finance isn't worsening debt risks in low-income countries. Australia should commit to deliver any new climate finance and loss and damage financing as grants, not loans.
> Metric: Conduct a gender and intersectional analysis of climate finance investments to ensure they reach affected communities, particularly women, people with disabilities, LGBTIQ+ and marginalised groups.

## A. Development outcomes at the heart

The first principle of any development financing mechanism, model or instrument, should be that it serves the objectives of Australia's wider international development strategy. At the highest level, that is to reduce poverty and improve human development outcomes; but also to advance gender equality, support climate change resilience and adaptation, improve peoples' access to basic services and expand economic opportunities (especially for those most marginalised). At a minimum, all developing financing should be aligned to and support the achievement of some of the SDGs, with a particular focus on poverty alleviation (SDG 1).

Beyond the traditional mode of development financing through ODA grant allocations, the Australian Government currently funds a range of worthwhile investment-based initiatives, is a shareholder of multilateral financial institutions that deliver development assistance and provides a small number of sovereign loans to support development objectives. The Government also invests and leverages investments in infrastructure and businesses in our region for geostrategic objectives. The two should not be confused, and geostrategic purchasing decisions should not come at the expense of, or be masked as, investments in regional development. There is also a vast difference in the capabilities required to deliver on these different mechanisms.

All development financing should be clearly aligned to the SDGs and the overarching objectives of the new IDS through a clear strategic framework and theory of change (see recommendation 2 below). The Australian government should also have strong monitoring and accountability to ensure that return requirements, debt risk, or other factors do not risk, dilute or impede development effectiveness. All non-development financing (i.e. investments or purchases for geostrategic, trade or economic purposes through EFA or the Future Fund) should at least adhere to 'do no harm' principles, be consistent with Australia's legal and human rights obligations, and align with the 2030 Agenda for Sustainable Development.

Ensuring that investments and development financing supports and strengthen local institutions, organisations and communities is a critical element of development effectiveness. Across all existing financing mechanisms, and any new instruments or institutions, the Australian government should ensure that local actors are involved in design, implementation and evaluation. There should also be clear exit strategies for international actors to prevent dependency and ensure that development financing strengthens the independence and sustainability of local institutions and organisations.

### EFA Powers

The creation of the AIFFP saw additional powers given to Export Finance Australia (EFA) to finance infrastructure projects in the Asia-Pacific. This review may provide an opportunity to consider whether EFA should play and greater role in the provision of other forms of development finance. Our firm view is that this is not an appropriate role for EFA.

First, EFA's primary purpose is to promote and support Australia's export industries through concessional finance and 'crowding in' financing from the private sector, not provide development finance (the two require vastly different mandates, incentives and capabilities). Second, there are significant transparency concerns relating to EFA's operations, including the partial exemption from the Freedom of Information Act. EFA provides minimal information about its transactions, on the basis that such information is commercial-in-confidence. In contrast, it is good practice for key information about aid and development projects to be disclosed to ensure accountability and transparency of public funding.

EFA is also required to ensure its financing is in Australia's national interest - including financing of infrastructure in the Asia-Pacific. This is at odds with the principles underpinning good development financing, which should prioritise the needs and interests of the recipient countries and focus on poverty alleviation. Similarly, while EFA has a policy and procedure on

Recommendation 1: Ensure development outcomes are the primary objectives of any development financing, ensure alignment with the objectives of the new development strategy, and institute strong accountability mechanisms to ensure development impact and effectiveness is prioritised.

Examples of this in practice: (i) Adopt a whole-of-government 'do no harm' and rights-based approach to investments in our region, which ensures any Australian government overseas expenditure or investment is aligned with the SDGs and meets legal and human rights obligations. (ii) Dedicated screening for development impact ahead of investment decisions. (iii) Consolidate Australia's use of development finance in line with the OECD principles (especially Principle 1) and ensure all financing meets the additionality test and good practice standards.

## B. Engaging philanthropic organisations

Philanthropic foundations play an important role in sustainable development – not only in mobilising financial resources, but also as development actors in their own right. Philanthropic foundations play an important role in sustainable development – not only in mobilising financial resources, but also as development actors in their own right. The combined weight of philanthropic foundations brings significant influence and resources to development and they are increasingly engaging in multi-lateral and global development forums (e.g. Gavi. The Vaccine Alliance). Including philanthropists and their foundations more strategically in policy discussions at the global and the local levels will build partnerships that both unlock development finance and optimise development results.

In Australia, the overall the overall quantum of philanthropic funds under management grew substantially from 2008 to over $17 billion in 2018, with expectations this number could double by 2030. This presents opportunities to leverage not only annual grant disbursements - With overall international philanthropic contributions estimated at $1 billion annually – but also to reform incentives to facilitate increased investment of philanthropy's corpus in development bonds, impact investment funds and other securities.

International development charities are actively searching for philanthropic partners and investors,  and we'd appreciate the Review acknowledging and respecting the Albanese government's policy to double philanthropy via charities by 2030 and to commit to spurring this in development finance partnerships via brokerage.[i] A undesirable outcome would be DFAT inadvertently crowding the market by having government step in to take charities place in collaboration with philanthropy in international development finance.

<u>Recommendation 2:</u>  Establish a comprehensive platform for harnessing philanthropic investment in development, building ties with philanthropic organisations and foundations and leveraging their interests and capabilities to support the government's objectives.

<u>Examples of this in practice</u>: (i) Establish an entity like Canada's Forum for Impact Investment and Development (CAFID) co-chaired by DFAT, the *Australian* Forum for Impact Investment and Development. This would be a platform for government, investors, NGOs and philanthropic organisations to coordinate activities. ACFID could assist.  (ii) Unlock philanthropic funding by establishing an outcome fund (funded via grants) for the government to invest alongside philanthropic foundations. (iii) Work with WOG partners to ensure legislative clarity to help unlock funds held in endowments. Providing guidance so that managers/trustees of endowments take a less conservative approach to investing.

## C. Sustainability of ODA

As the scope of the review rightfully notes, these innovative financing instruments are a ***complement*** to grant financing. ODA remains the most important source of funding for development across our region and globally; for least-developed countries it comprises over two thirds of external financing. And many blended finance or concessional lending models rely on substantial grant financing to leverage private capital or make loans viable for emerging economies.

Australia's current development budget settings do not reflect our changing strategic circumstances, our regional and global interests, or our values. Despite recent temporary increases made in response to COVID-19, Australia's development cooperation budget, measured both as a share of national wealth over time and compared with other OECD donors, has remained at historic lows over the last several years. A longer-term budgetary framework will help to give confidence and stability to Australia's partner countries, implementing partners of the aid program, and new partners or investors in any new financing mechanisms.

<u>Recommendation 3:</u> Deliver an ODA budget framework aligned to the new development policy which includes legislated, stepped targets for achieving 0.7 per cent ODA of GNI by 2030 target that Australia agreed to as a signatory to the SDGs.

This would include a legislated commitment to reach 0.5 per cent ODA of GNI by FY25-26, and 0.7 per cent by FY-29-30.

## D. Transparency & accountability

Transparency is essential to ensure the coordination, accountability and effectiveness of Australia's development financing efforts. It enables stakeholders, the public and investors to assess and identify whether funds have been allocated appropriately and effectively. Transparent reporting systems and metrics can also help financing institutions and investors track and monitor development outcomes against their goals and objectives. Transparent allocation and measuring mechanisms may also encourage investors and partners to support future development initiatives.

Consistent with Principle 5 of the OECD Blended Finance Guidelines, the Australian government should:

- Make publicly available information relating to the investment decisions, implementation and results of all development financing activities, including project evaluations, environmental and social impact assessments and management plans, and historical project data.
- Ensure there is independent oversight on investment decision making, and rigorous processes to manage potential conflicts of interest.
- Create independent complaint mechanisms which is free and easily accessible for all stakeholders. The Government should ensure that there is independent oversight over how investments are made to avoid conflicts of interests from arising. (As highlighted as a key recommendation for future programming in the Pacific Rise final evaluation report)[ii]

*Publish What You Fund* have recently announced the development of a 'DFI Transparency Index' (akin to the Aid Transparency Index) which will be released for the first time next year. Whether or not Australia has a DFI, we suggest that the DFI Transparency Tool offers a useful benchmark for the transparency of Australian development finance, and should be adopted across all Australian government initiatives.[iii]

<u>Recommendation 4:</u> Ensure the transparency and accountability of Australia's development financing by making information about investment decisions, implementation, and results publicly available. Ensure there is independent oversight and an impartial and effective complaints mechanism for all activities.

<u>Examples of this in practice:</u> Reporting should include ODA and non-ODA finance both through the budget papers and more regular public reporting.

## E. Strategic coherence & fit-for-purpose capabilities and governance

While Australia currently employs some effective financing instruments, greater strategic coherence is urgently needed to enhance Australia's development financing efforts and ensure that all initiatives are consistent with development objectives. The benefits of these various initiatives, and opportunities to learn from successes and failings, would be enhanced by bring these instruments together. A more centralised approach to programming in this space would also enable better visibility of opportunity costs, room for growth, capability needs and monitoring of development outcomes.

To deliver on the above objectives (strategic coherence and centring development impact) the Australian Government should review the institutional arrangements, capabilities and monitoring and accountability structures that currently support development financing efforts, with a view to:

- Centralise governance or institutional arrangements for the oversight of development finance instruments within a department (i.e. DFAT) or as a standalone institution.[1]

[1] Whether this takes the form of a standalone institution or not, there needs to be collaboration between investment teams and country/sector experts within DFAT to ensure that a) the targeted countries are those most in need of finance; b) political economy analysis is considered; c) proposed investments are aligned with the country's own develop strategies and priorities (this benefits the investment as it makes it easier to remove any roadblocks; and d) investments prioritise those most in need or underserved by the current economic conditions.

- Ensure that this department/**institution has a clear mandate** to work towards the achievement of the SDGs and objectives of Australia's new strategy for international development. Development finance activities should not be housed in quasi-commercial entities such as Export Finance Australia (EFA), which does not have the requisite expertise and knowledge of international development dynamics and objectives.
- Instate an **overarching strategic framework** for Australia's use of innovative developing financing modalities, outlining a theory of change for how Australia's development financing will advance the SDGs, as well as the objectives and principles that should guide decision making on why, where and how Australia provides fit-for-purpose financing to maximise development impact.
- Develop and implement a **holistic and unified MEL framework** to support high standards for performance and impact across the portfolio, which includes the capacity to undertake baseline assessments to support impact reporting.[2]
- Ensure that **development experts are involved** in the design, implementation, and M&E of all development financing activities. As experienced and knowledgeable development actors, NGOs will be important partners.
- Undertake a thorough analysis of the **capabilities and skills** required to build out an effective development financing division or institution, and a plan for how Australia will recruit, retain and build this expertise in-house.
- To enable effective blended finance approaches, the Government must ensure that its **risk appetite** enables calculated risk taking in backing new ventures or projects. The role of public finance in blended finance is to be the 'first mover' and absorb the risk that is preventing initial private investment. This will ensure that Australian ODA deployed in blended finance is being genuinely catalytic and crowing in additional capital that would not have been attracted otherwise – the but-for/ additionality test (see recommendations below on this in the context of blended finance).

To enable this flexibility and accommodate the inherent risk calculus in blended finance approaches to development, it may be necessary to house these activities in a discrete body or institution (such as a DFI which is common in many OECD countries) with separate governance structures and oversight mechanisms (rather than within DFAT).

**Should the Australian Government establish a Development Finance Institution (DFI)?**

While many OECD countries have DFIs (eg US, Canada, Germany and UK), the Australian Government's model should depend on analysis of our own circumstances, needs, and capabilities. Initial steps to establish either a central coordinating office in DFAT or a DFI should be guided by similar principles and objectives. These include: appropriate independence and clearly-defined purpose and objectives, a development impact focus, and a stepped-approach to strategic coherence across all development finance. The functions would include setting strategy, providing expert advice and oversight, balancing risk and effectiveness, investment decision-making, ensuring accountability, building development and

<u>Recommendation 5:</u> Do not expand Export Finance Australia's role in financing development projects. Deliver all development financing under a strong institutional mandate to promote inclusive and sustainable development, with expertise and governance arrangements to match. (See Recommendation 6)

<u>Recommendation 6:</u> Consolidate all development financing instruments in either an internal DFAT division or a standalone institution that has the expertise and a clear mandate to promote development objectives through innovative financing modalities. (See box on Establishing a DFI)

<u>Examples of this in practice:</u> Develop and implement a strategic framework and theory of change for ensuring development financing maximises development impact, including a unified MEL framework, and a plan to build out the necessary skills, capability and risk calculus.

[2] Existing bilateral DFIs don't usually have baseline assessments to measure the impact of their investments against. We understand that the US government's DFI IFC is beginning to work on this, but no results are available at this stage.

Recommendation 7: Strengthen DFAT's initial good work on leveraging investment towards gender equality. DFAT initiatives like Investing in Women and EMIFF take a strong approach to gender equality.

Examples of this in practice:( (i) DFAT look to engage in the broader 2X challenge on gender lens investing. (ii) AIFFP also works towards gender equality.

## F. Enabling & harnessing the role of NGOs & development agencies

The Australian Government should engage with NGOs as knowledgeable development experts and valuable partners in expanding its innovative development finance instruments, including impact investing and blended finance.

This will require dedicated attention and resourcing (budget and capability) to enable Australia's financing modalities to engage with development organisations and NGOs. This may require a central unit for NGO coordination and partnership, which has a clear mandate to engage with NGOs on the provision of technical assistance, investments and other areas.

NGOs can play a wide range of roles, depending on the financing instrument and its objectives:

- Investor: putting up capital with the expectation of a financial return (or, at a minimum, a preservation of capital).
- Donor: putting up capital with no expectation of repayment or a financial return.
- Recipient: being on the receiving end of a donor's or investor's capital, as a service provider or social enterprise.
- Intermediary: facilitating or managing flows of capital between two or more parties (but not the direct investor, donor, or recipient).
- Technical assistance provider: providing specialized services or expertise (sometimes under contract) (e.g., data sourcing/verification).
- Evaluator: independent evaluator/verifier of results achieved.
- Advocate or convener: lobbying for reforms and playing a convening role among different stakeholders.

Across these disparate functions, NGOs bring the following experience, knowledge and capabilities:

| NGOs value-add | Examples of this in action |
|---|---|
| On-the ground presence and networks<br>NGOs can add value to government and private sector financing efforts through their connection to local communities. In the course of their programming work, NGOs build and maintain networks with a broad range of local institutions and organisations, including investment-ready SMEs.<br>There is the opportunity to engage NGOs in project development and investment decision making as intermediaries and brokers to enable investment and cultivate opportunities for the growth of local economies. | In Indonesia and Cambodia, Good Return works with local financial institutions to broker and guarantee loans to SMEs who would be otherwise unable to access the capital they need to grow (women entrepreneurs in particular often lack the collateral required to borrow from banks).<br>Between January 2021 to June 2022, in the midst of the COVID-19 pandemic, 288 SMEs in aquaculture, chilli, maize, rice and cucumber farming accessed AUD $2.76 million in loans from local financial institutions in Cambodia and Indonesia using Good Return's loan guarantees. 238 (83%) of these SMEs are owned by women. 2,194 jobs were created or sustained in rural areas of Cambodia and Indonesia. |
| Knowledge of local contexts<br>Innovative development financing approaches often fail to reach their potential due to the mismatch between the design of these mechanisms, and the needs & interests of actors in the local context. | NGOs are often equipped with a strong understanding of the political economy in local contexts (knowledge which investors and fund managers often lack).<br><br>ACFID's members currently deliver 2758 projects in over 93 countries across a wide range of areas – from education, to health, economic development and |

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| NGOs deep understanding of social challenges can serve as an important check on entrepreneurial and commercial approaches to solving development challenges. | financial inclusion. Many of these projects and partnerships are longstanding, having run for many decades. Through these projects NGOs regularly identify opportunities for investment by development donors, and in some cases, have taken up a financing role themselves (see below). |
| **Sector and technical expertise in development**<br>For decades NGOs have been working with local communities to deliver development assistance that meets their needs. This technical expertise – whether in gender-responsive design, disability inclusion, or monitoring, evaluation and learning of programs and investments.<br>NGOs can serve as technical assistance providers to support investment readiness, mentoring, training and project identification and development work. | Good Return provides financial education training to support financial inclusion for marginalised people based on a 'strengths-based approach'. Good Return has also delivered training on Gender Equality and PSEAH to fintech organisations in Indonesia.<br><br>NGOs also have a vital role in supporting the social infrastructure that often underpins the effectiveness of blended finance instruments, including in lower-income countries where markets are less developed. For example, NGOs support the development and growth of micro-enterprises/entrepreneurs that contribute to the impact investment pipeline.<br><br>For example, the Oxfam Enterprise Development Program works with entrepreneurs in Bangladesh, Ethiopia, Honduras, Nepal and Rwanda to grow successful businesses. This includes an intelligent mix of loans, grants, and business mentoring including facilitation of linkages to financial systems. |
| **Impact-first early stage financing**<br>In many cases, NGOs provide funding to early stage SMEs or up-starts to enable their growth, either as investors or donors. | Save the Children's Impact Investment Fund provides loans and equity investments to help startups and social enterprises grow. Areas include EdTech, Fintech, and e-health to support rapid progress for children around the world. The fund provides flexible finance from $100,000 to $1 million to not-for-profit and for-profit organisations in Australia and overseas.[iv]<br><br>In 2018, the Fred Hollows Foundation joined others in the innovative financing space to launch the first Development Impact Bond (DIB) for eye health. Supporting the expansion of an eye hospital in Cameroon, the 5-year DIB is a pay-for-performance mechanism whereby payments are made when targets are met. FHF helped develop the MEL framework, ensure equity targets were central to its design, and took a 7% stake as an outcome funder. At the end of year 3, targets were met and investors enjoyed an early, partial payout, providing the model can work. NB: The US Int'l Development Financing Corp (USAID's DFI) is a significant impact investor in the DIB.<br><br>The Fred Hollows Foundation provided early, catalytic financing to Alina Vision, a social enterprise eye hospital offering high-quality, accessible services for a range of prices based on the patient's ability to pay. Having proved the business model works, it is now poised for growth and is seeking a blended mix of financing (debt, equity, grant) from the market. |

| Advanced measurement tools and frameworks<br>NGOs are well practiced in measuring the impact of their work, and instituting tools and frameworks that ensure development outcomes are achieved. | As part of their day-to-day work and operations, NGOs continually monitor and evaluate the effectiveness of humanitarian and development activities. This is a vital skillset in any development financing initiative.<br><br>As well as the standards for practice enshrined in the ACFID Code of Conduct and good practice frameworks and guidance, some NGOs have developed specific impact measurement frameworks and standards for development financing. For example, Good Return has developed Responsible Investment Principles to assist its partners to be inclusive and responsible financial providers in accordance with relevant rules of the countries where Good Return operates. These principles assist impact investment decision-making by highlighting opportunities and potential risks that could impact projects supported by social investors. The principles also help to protect and build the financial resilience of Good Return's local FSP partners and especially their clients. |
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Internationally, there is substantial engagement between government, the private sector and NGOs on investment-based approaches to development.[v] This cross-sector partnership is more nascent in Australia and should be developed.

Recommendation 8: Leverage the expertise of NGOs as important partners in development financing activities. Enable the range of roles that NGOs can play as investors, intermediaries, technical assistance providers.

Examples in practice include:

(i) Invest in new funding models: fund a series of Development Impact Bonds.

(ii) Unlock investment capital. Establish a blended finance mechanism for foundations and investment funds to invest alongside the government in development initiatives (application of grants and debts, could be extended to guarantees and equity)

(iii) Create an investment window in the Emerging Markets Impact Investment Fund (EMIIF) of $50 million for NGO-led impact investment funds and $50 million for clean energy transitions, climate finance.

(iv) Utilise NGOs as social impact technical assistance providers to conduct pre-investment assessments and verify social impact of investments.

(v) Support the upskilling of NGOs (in Australia and our partner counties), including access to training, events and workshops, to equip them to deliver monitoring of programs for development impact.

Recommendation 9: Address barriers to NGOs operating as actors in the development financing landscape

Examples in practice include:

(i) Proactive endorsement of NGOs acting in this space with ACNC guidance note.

(ii) Provide a funding mechanism to assist NGOs in making the transition from grant-based funding models to impact investment models.

(iii) Coordinate with WOG partners (e.g. ATO) to help secure provision of concessional tax treatment for investments made in impact investment funds.

## G. Blended finance

Using public finance to leverage or catalyse private investment can enable Australian ODA to achieve stronger development outcomes and more efficiently. Moreover, using blended finance modalities for some projects will free up ODA budget for projects that are best delivered using grant-based funding (such as humanitarian assistance and work in conflict-affected or fragile states). As a complement to an increased ODA budget, Australia should strengthen its efforts to leverage private investment in development outcomes in line with the OECD DAC principles and guidelines on blended finance. In doing so, it should draw on the experience of other countries experience in blended finance through DFIs, as well as state government-led initiatives to promote impact investment for positive social and environmental outcomes.

The government should expand its **toolkit of financing instruments** and ensure there is **flexibility** in how these instruments can be used to best meet specific development objectives, which are support the priorities and needs of our partners. Different development objectives require different kinds of finance. It is important that the Australian government appropriately matches needs to the most effective modalities.

Blended finance is one broad mechanism in the development finance toolkit and can encompass a range of instruments such as first-loss equity, impact bonds, guarantees and insurance. Alongside these blended finance instruments, the Australian government must have a sizeable grant pool to support capacity building of local institutions, technical assistance, training and learning which will help to build inclusive markets, support financial inclusion for marginalised groups and promote inclusive and equitable economic growth. Without grant funding to ensure that financing tools are catalytic and concessional, there is minimal value-add to a blended finance approach.

Rather than duplicate the models of other countries DFIs, which might see us competing for the same projects & deals, or simply investing alongside them, Australia should carve out more niche spaces where we can be more targeted and catalytic (e.g. early-stage/design financing and guarantees and working in less-developed markets). This may require being more concessional than other actors are currently, and investing in market development and financial inclusion as the foundations of inclusive and equitable economic growth. In many sectors (such as education, health and WASH), public funding, whether through taxes or transfers, will remain an important part of the solution (hence our recommendations on ODA levels below). But attracting private capital to investable transactions in line with a strong development mandate will allow traditional development aid and government funds to refocus on projects and enterprises that should not or cannot attract private capital or make a return.

Effectively unlocking private investment towards inclusive, equitable and sustainable development requires a significant, sustained and collective effort by government, the private sector and civil society organisations. There are risks inherent in blended finance – primarily, that return requirements will be prioritised over development impact and that precious ODA will be used to leverage finance towards projects that achieve minimal impact for those most in need. In order to ensure that development impact and locally-led development are not compromised in innovative blended finance approaches, it is essential that the Australian Government ensures all blended finance initiatives:

- Attracts <u>additional</u> capital to financing for sustainable and inclusive development (the aim is to mobilise additional commercial finance that otherwise would not have investing in lower-income countries to achieve the SDGs).
- <u>Adheres to best practice</u> principles, noting that what constitutes good practice will vary based on the objectives, scope, country context, needs and actors in any specific project or deal

The review terms of reference ask about best practice for blended finance. The OECD DAC Principles for Blended Finance offer a useful (if very broad) starting point and must be adhered to across all Australian Government blended finance initiatives. To ensure all blended finance initiatives meet the overriding objective of maximising development impact, the Australian Government should:

- Ensure that there is no preference (explicit or implicit) for working through donor-country based companies over local institutions and organisations (for example in the ownership, board membership or decision-making frameworks for development finance mechanisms).[3]

[3] An exception to this may be specific programs that aim to export technical competencies, which allows for knowledge transfer and sharing between countries. The work of the German organisation DeveloPPP.de is an example of this.

- Adopt policies and approaches to project selection which prioritise investments in companies, countries and activities with a higher development dividend (e.g. require a minimum share of investment in lower income countries) This may necessitate Australia placing a strong focus on market-development initiatives in the medium term, while leveraging private investment in these countries would be a longer-term objective.
- Ensure that governments, institutions, civil society and private sector organisations in partner countries (where investments are being made) are consulted and involved in decision making at all stages
- Ensure that projects are aligned with national development priorities and avoid all projects where there is a risk of labour standards and/or human rights violations
- Maintain high standards for transparency and accountability (see recommendation below).

On overheads & management fees –

It is expected that over time, as mechanisms such as EMIIF generate returns on their investments and build their investment capital, that the relative management costs for these programs will come down. Across all development financing instruments, overhands and management fees should be proportionate to the amount invested in local organisations, institutions and economies. This should include, wherever possible, working with local organisations and institutions to strengthen their capacity and support their priorities, with clear exit plans for international actors.

To support effective blended finance initiatives, the Government should also look to **strengthen the enabling environment for blended finance,** including for NGOs who have impact investment funds and involved in blended finance structures. Current barriers (beyond the lack of financing) to the scale of blended finance include  the lack of market demand and supply; lack of policy, regulatory and legal frameworks; lack of capacity; and, depending on the development sector targeted for blended finance, reform of domestic tax and tariff structures. This needs to be considered in the Australian context, as well as where investments are being made.

For example, a key barrier to the use of blended finance structures in the WASH sector in India, is the regulatory constraints. Analysis by the RTI indicates that the provisions of the Companies Corporate Social Responsibility Rules (CSR) and the Foreign Contribution Regulation Act (FCRA) is preventing some donors from adopting blended finance mechanisms more broadly.[vi]

The Australian Government should review commonwealth laws governing impact investing, including financing investments overseas. DFAT should also ensure that its accreditation processes for NGOs can accommodate these new ways of working.

See Recommendations 1, 4, 5, 6 and 7 above.

## H. Debt

Around the world, levels of public debt are on the rise with over 60% of low income countries either in debt distress or at risk of it.[vii] Within our region, the most recent IMF-World Bank debt sustainability analyses have classified seven Pacific countries as being at high risk of debt distress, with two more at moderate risk of debt distress. Climate change also poses an economic threat across the Indo-Pacific region, with countries facing the possibility of significant economic and non-economic losses from natural disasters.[viii]

In this context, it is critical that any change in Australia's approach to development financing does not exacerbate debt burdens for low-income countries, particularly in the Pacific region. While there may be room for highly concessional loans for projects with a strong economic and development case, in reality the fiscal space to repay debt is limited in most Pacific countries, where much of our aid is directed. Given the risk that countries may struggle to repay a debt, any sovereign financing to these nations should predominantly be grant based. Any aid or climate finance provided as debt-financing (sovereign or non-sovereign) should be delivering clear and urgent development benefits and be an articulated priority for the recipient governments.

ActionAid research found that for many low-income countries one fifth of the money that could be spent on public services is earmarked for repayments to international creditors. The consequence of this is that public services such as healthcare and education are left chronically underfunded, or governments respond to funding gaps by increasing the privatisation of public services, including public infrastructure.[ix]

Careful attention should be paid to the impact of underfunding or privatising public services through the provision of development assistance. Women and girls can be negatively impacted when public services are underfunded or privatised. Women have a greater reliance than men on public services such as childcare and education to enable their workforce participation due to gender norms; and health care facilities and hospitals to support their reproductive and maternal health care needs. The availability of safe and affordable public transport also plays an important role in their mobility. Women are most impacted by the reduced availability and accessibility of public services, as well as increased cost when services are privatised. Women also pick up the burden when public services are unavailable due to their gender roles, meaning that debt distress results in a continued dependence on women's unpaid care and domestic work.[x]

Recommendation 10: Ensure our loans do not add to debt distress and do achieve development outcomes. Where aid is provided as loans or other debt instruments, these should be: highly concessional, never provided to countries at moderate or high risk of debt distress; and only used where the initiative to be financed reflects the priorities of the recipient country and has a clear development and poverty-alleviation benefit.

Developing country debt payments are currently the highest they have been in 20 years and are drawing resources away from investments in health, education and economic development. During the pandemic, 64 lower-income countries spent more on debt repayments than on healthcare.[xi] A stronger and more development-focused global debt architecture could see these funds mobilised to finance development within low-income countries. Sri Lanka's recent debt crisis, which has seen dramatic increases to cost of living impacting most heavily on the poor, and widespread political unrest, also highlights the human impacts and risk to regional security if debt concerns are unmet. As economics professor Jayathi Gosh has commented, similar crises are likely to emerge elsewhere: "contagion is all too likely, and it will affect not just economies that are already experiencing difficulties, but a much wider range of LMICs that will face real difficulties in servicing their debts".[xii]

During the COVID-19 pandemic, the G20 put in place the Debt Service Suspension Initiative (DSSI), which paused debt repayments for the poorest countries between May 2020 and December 2021. DSSI borrowers committed to use freed-up resources to increase social, health, or economic spending in response to the crisis. After the DSSI expired, the G20 made the Common Framework for Debt Treatments available as an option for countries to access support with debt restructuring or rescheduling. However, this framework has had limited uptake and has been criticised for its slow process with uncertain timeframes and outcomes for debtor countries and reliance on voluntary participation from private creditors.[xiii] The framework is also only available to low-income countries - Sri Lanka, for example, had to request reclassification as a low-income country in order to apply to the scheme.[xiv] A reformed global debt architecture, with greater options for debt relief and restructuring, would free up low-income country resources for development and humanitarian needs while avoiding the security risks associated with a debt crisis in our region.

Recommendation 11: Australia should work with G20 and OECD countries to strengthen the global debt architecture and provide stronger options for debt relief and restructuring.

## I. AIFFP

A key recent development in Australia's development financing was the creation of the AIFFP. While the AIFFP represents a welcome focus on the Pacific region, there are a number of elements of its design that undermine its effectiveness as a vehicle to support poverty alleviation and resilience in the region.

First, the AIFFP has a combined geostrategic and development focus. The AIFFP was established in 2018 as part of the Morrison Government's "Pacific Step Up".[xv] It was widely seen as a response to China's growing influence in the Pacific, and a mechanism through which Australia could counterbalance China's Belt and Road Initiative.[xvi] AIFFP's program portfolio includes several projects that appear to be a direct response to proposed Chinese investments. For example, the announcement of AIFFP's financing of the East Micronesia Cable, in partnership with the US and Japan,[xvii] came after Chinese telecommunications firm Huawei had submitted a highly competitive bid to build the cable.[xviii] There is a risk that AIFFP's geostrategic focus will come at the expense of its development focus, which should be the primary purpose of financing that draws on Australia's limited aid budget.

Debt sustainability concerns in the Pacific, combined with the small scale of many Pacific countries' economies, also poses challenges for the AIFFP's project pipeline. While the AIFFP has $500 million to provide in grants and $3 billion in loans, in practice there are restrictions that hamper its ability to offer loans and several countries in the region to which it is only able to offer grants.

As AIFFP's grant component is combined with its loan component to make the loans concessional, its ability to offer concessional loans is limited by its available grant funding. It is unclear how much the AIFFP has spent or committed to. estimates based on publicly available information suggest AIFFP has committed around $670 million in loans, over $60 million in guarantees and around $185 million in grants[xix]. This suggests around 25% of its spending to date has been in the form of grants (either standalone, or combined with loans to provide concessionality). However, this ratio will not be able to be maintained as AIFFP's remaining grant allocation is only 13% of its remaining loan allocation, raising questions about how it will ensure future financing is appropriately concessional.

AIFFP also has the option of lending directly to the private sector using a market pricing approach. However, this requires a pipeline of private sector projects that have sufficient commercial prospects and also meet AIFFP's development criteria. Again, this is challenging in the Pacific context. The challenge in finding appropriate commercially viable projects raises the risk that AIFFP will invest in projects that are not focused on poverty alleviation or that may be better left to private investors rather than being financed through an Australian aid mechanism.

Transparency is a further concern with AIFFP projects. The AIFFP does not make project design documents available on its website and provides very minimal information about the project's aims and objectives, locations, implementing partners, timeframes and funding structures. This contrasts with other Australian aid facilities, which often publish annual progress reports, updates from project partners and relatively detailed project information. It also contrasts with MDBs - for example, the ADB generally provides detailed Project Data Sheets, evaluation documents and safeguards reports on its financing facilities.

As one example of the issues discussed above, AIFFP's largest announced project to date is a project to upgrade seven ports in Papua New Guinea involving a combined AU$580 million in loans and grants.[xx] Despite the size of the project, very limited information is available on AIFFP's website about this project. In particular, it is difficult to ascertain the business case behind some of the selected ports and it is unclear whether a thorough social and environmental assessment has been done. One of the ports - Vanimo in West Sepik Province - is a site where there are a number of logging and palm oil operations that have been linked to illegal activity.[xxi] It is also the proposed export site for the Frieda River Mine, which is the subject of a human rights complaint before the Australian government.[xxii] It is unclear whether the risk of facilitating activities that are illegal, unsustainable or contrary to human rights has been factored into the decision to finance expansion of this port.

<u>Recommendation 12:</u> Urgently undertake a review of the AIFFP, including by accelerating the Auditor General's potential report. No expansion of the AIFFP should be considered (including the proposed Climate Infrastructure Window) until this review has been carried out. The review should assess the effectiveness of the AIFFP in realising development benefits and meeting the needs of partners across the Pacific region.

## J. Climate Finance

Australia has committed $2 billion in climate finance over 2020-2025. This is approximately one-tenth of our fair share of the 100 billion USD goal, which is $4 billion annually in new and additional finance.[xxiii] Australia's climate funding also comes from within an already stretched aid budget, meaning that climate finance risks diverting aid funding away from critical spending on health, education and other essential efforts to reduce poverty. It is critical that Australia achieves its climate finance fair share, alongside its aid obligations. An additional commitment on loss and damage finance is also a crucial element of a comprehensive and ethical climate policy.

There are strong indications that Australia is considering a greater focus on loan-based and blended finance as a part of a growing pot of climate funding. The Australian Climate Finance partnership was announced in 2021, which is an Australian Government initiative with the Asian Development Bank providing up to $140 million to accelerate private sector investment in low-emission, climate-resilient solutions for Pacific Island countries and Southeast Asia. Further, the newly elected Labor Government made a pre-election commitment to establish a Pacific Climate Infrastructure Financing Partnership within the AIFFP,[xxiv] which opens up new possibilities for loan-based climate finance to the Pacific region (refer to the above section on AIFFP).

In considering the expansion or additional financing mechanisms (sovereign and non-sovereign), the Government must ensure that Climate Finance is:

- Aligned to low-income countries' climate agendas, particularly adaptation needs;
- Accountable to development effectiveness principles;
- Is concessional and does not exacerbate debt distress;
- Clearly & consistently reported (note recommendations on transparency and effectiveness elsewhere in this submission);
- Not contributing to the privatisation of services that should, for reasons of inclusion, equity or otherwise, be delivered as public services;
- Addressing the expectations and challenges faced by women, people with disabilities, LGBTIQ+ people and other marginalised groups.

With international climate finance negotiations now focused on the post-2025 global financing goal, Australia's leadership is critical in ensuring an ambitious, effective and equitable approach to international climate finance. The government must focus on increasing climate finance contributions, while ensuring that climate investments are low-income country led and designed to meet the needs of local communities, particularly women and girls, people with disabilities, LGBTIQ+ communities and other marginalised groups.

<u>Recommendation 13:</u> In developing or reforming development financing modalities to help Australia meet its climate finance fair share and related obligations, the Australian government should:

a. increase its climate finance to $3 billion for 2020-2025, alongside a clear plan to achieve its fair share of the USD 100 billion goal by 2025 - determined as $4 billion annually;
b. ensure Australia's climate finance isn't worsening debt risks in low-income countries climate finance Australia should commit to deliver any new climate finance and loss and damage financing as grants, not loans or support for insurance; and
c. conduct a gender and intersectional analysis of all climate finance investments to ensure they are designed to reach affected communities, particularly women, people with disabilities, LGBTIQ+ communities and other marginalised groups.

## Endnote

[i] https://www.andrewleigh.com/labor_to_double_philanthropic_giving_by_2030_media_release
[ii] www.pacificrise.org/wp-content/uploads/2021/06/Pacific-RISE-Final-Evaluation.pdf
[iii] www.publishwhatyoufund.org/projects/dfi-transparency-initiative/
[iv] www.savethechildren.org.au/get-involved/partner-with-us/impact-investment-fund
[v] For example, the Canada Canada Forum for Impact Investment and Development (CAFIID) is a community of individuals, organizations and investors who treat positive social and environmental impact and financial return as coexisting priorities. They seek to strengthen Canada's contribution to global impact investing by providing members opportunities to learn, share, collaborate, and act as a collective voice. www.cafiid.ca/about-cafiid
[vi] www.rti.org/insights/wash-infrastructure-private-sector-challenges-part-3
[vii] Marcello Estevao (2022) "Are we redy for the coming spate of debt crises?" World Bank Blogs, https://blogs.worldbank.org/voices/are-we-ready-coming-spate-debt-crises
[viii] IMF, List of LIC DSAs for PRGT-Eligible Countries, as at 22 May 2022, available at: www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf However, note Rajah and Dayant have pointed out that these DSAs may overstate the risks in the case of Pacific countries
[ix] Ibid, p. 31
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[xi] Debt Justice UK (2020) "Sixty-four countries spend more on debt payments than health", https://debtjustice.org.uk/press-release/sixty-four-countries-spend-more-on-debt-payments-than-health
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[xvi] www.smh.com.au/politics/federal/scott-morrison-splashes-cash-in-the-pacific-as-china-fears-loom-20181107-p50emv.html
[xvii] Senator the Hon. Marise Payne, 'Improving East Micronesia telecommunications connectivity,' Joint media statement with: His Excellency David W. Panuelo, President of the Federated States of Micronesia; His Excellency Yoshimasa Hayashi, Minister for Foreign Affairs, Japan; His Excellency Taneti Maamau, President of the Republic of Kiribati; His Excellency Lionel Aingimea, President of the Republic of Nauru; The Honorable Antony J. Blinken, Secretary of State, United States of America, 12 December 2021, available at www.foreignminister.gov.au/minister/marise-payne/media-release/improving-east-micronesia-telecommunications-connectivity
[xviii] www.abc.net.au/news/2021-12-12/new-undersea-cable-internet-pacific-australia-us-japan/100694212
[xix] Calculations based on review of AIFFP website (https://www.aiffp.gov.au/), supplemented with information supplied by DFAT. Information may not reflect up to date estimates where figures have not been publicly released.
[xx] AIFFP, Papua New Guinea ports infrastructure program available at https://www.aiffp.gov.au/investments/investment-list/papua-new-guinea-ports-infrastructure-investment-program
[xxi] See: www.globalwitness.org/en/campaigns/forests/true-price-palm-oil/
[xxii] Frieda River Limited, 'The Sepik Development Project: Sepik Infrastructure Project,' at 1, available at https://friedariver.com/wp-content/uploads/2019/09/SDP_Sepik-Infrastructure-Project_September-2019.pdf
[xxiii] Based on Australia providing an average annual contribution of $400 million over 2020-2025, bringing its total finance for that period to $2 billion.
[xxiv] Australian Labor Party (n.d) *Pacific Climate Infrastructure Financing Partnership*, www.alp.org.au/policies/pacific-climate-infrastructure-financing-partnership; Australian Infrastructure Financing Facility for the Pacific, *Climate Change*, https://www.aiffp.gov.au/climate-change