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Enhancing coordination between European donors, development agencies and DFIs/PDBs

Insights and recommendations

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ETTG study conducted for the Practitioners' Network for European Development Cooperation

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The views expressed in this paper are those of the authors.

EXECUTIVE SUMMARY

With the increasing reliance on development finance to mobilise resources and catalyse private sector initiatives and finance at scale for greater sustainable development impact, a parallel impetus has emerged to foster more coherence and synergy among development actors. The European Union (EU) is at the forefront of this endeavour. Collectively a major economic powerhouse, and the world's largest provider of official development assistance (ODA), the EU is engaged in a process of combining its various tools and objectives towards achieving the Sustainable Development Goals (SDGs).

A key means to realise this objective is greater coordination between donors, implementing agencies and financial institutions for development – i.e., development finance institutions (DFIs) and public development banks (PDBs). Building on the Team Europe and 'Working Better Together' approaches, the 'policy-first' principle, and European values and objectives, the EU is giving new impetus to coordination efforts – to take full advantage of its budgetary and policy frameworks, with a view to strengthening the European financial architecture for development (EFAD). Key elements of this architecture are 'Global Europe' – which is the EU's Neighbourhood, Development and International Cooperation Instrument (NDICI) – and the European Fund for Sustainable Development Plus (EFSD+).

EXECUTIVE SUMMARY (CONTINUED)

An important question in this endeavour is how coordination between the roles and activities of European donors, implementing agencies and DFIs/PDBs can best be articulated and implemented in practice. This note draws insights from coordination experiences of a range of European actors, including the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD), France, Germany, Italy, the Netherlands, Spain and the United Kingdom. Specifically, it synthesises lessons from case studies carried out by members of the European Think Tanks Group (ETTG) for the Practitioners' Network for European Development Cooperation. The main insights are summarised below:

1. OBJECTIVES OF COORDINATION

Complementing resources and tools for impact
- Optimising the use of technical assistance, including linking capacity building to development finance
- De-risking public and private investments by leveraging donors' guarantees and other financial instruments
- Beyond tools, pooling together a unique set of knowledge, expertise and resources

Paving the way for a more comprehensive and synergetic approach
- Adopting a comprehensive approach to investment, including a combined public and private financing of integral projects
- Linking projects and shifting from project to systemic impacts
- Enabling 'escalator' or 'cascading' engagement to shape markets

Working towards specific common issues
- Developing a pipeline of bankable projects
- Ensuring solid impact reporting
- Enabling DFIs/PDBs to be responsive in times of crisis

2. CHALLENGES OF COORDINATION

Institutional and legal challenges
- Asymmetry in objectives and incentives
- Lack of geographical, thematic and sectoral alignment
- Differences in legal frameworks
- Asymmetry in size and power relations

Challenges relating to resources and capacities
- Different languages and capacities, and insufficient interconnections across networks
- Different tools and resources
- Additional time and resources spent
- Lack of local presence of DFIs

Challenges related to processes
- Differences in procedures and speed
- Different time horizons
- Linking technical assistance to investments, avoiding tied aid
- Lack of attention to local ownership and capacity building of the local ecosystem

3. RECOMMENDATIONS

1. Identify clear, pragmatic and achievable cooperation objectives, focused on a few core initial objectives
2. Focus on alignment of key objectives and incentives, based on simple processes (avoid complexity and bureaucracy)
3. Meet on a regular basis (formally and informally), and support secondment opportunities, to better know and understand each other and build trust
4. Donors do not need to lead the coordination. While their strategic steering is important, they can support (rather than lead) on operational matters, with DFIs/PDBs and implementing agencies playing a key role
5. Allow for trial and error, innovation and pilot initiatives, then scale up and replicate successes
6. Adopt a long-term approach, aiming to shift from ad-hoc coordination to more systemic cooperation
7. Consider including other actors (e.g., the private sector, non-governmental organisations and local counterparts) in coordination involving donors, implementing agencies and DFIs/PDBs, and promote adaptation and transformation
8. Build on the 'Team Europe' and 'Working Better Together' approaches, pulling other donors and DFIs/PDBs into successful partnerships, including through local platforms
9. Foster standardised and simple procedures and M&E processes, avoiding procedural over-burdening
10. Engage in peer reviewing, lesson sharing and critical assessment

SYSTEMIC SHIFT TOWARDS THE PRIVATE SECTOR, FINANCE MOBILISATION AND THE EUROPEAN FRAMEWORK

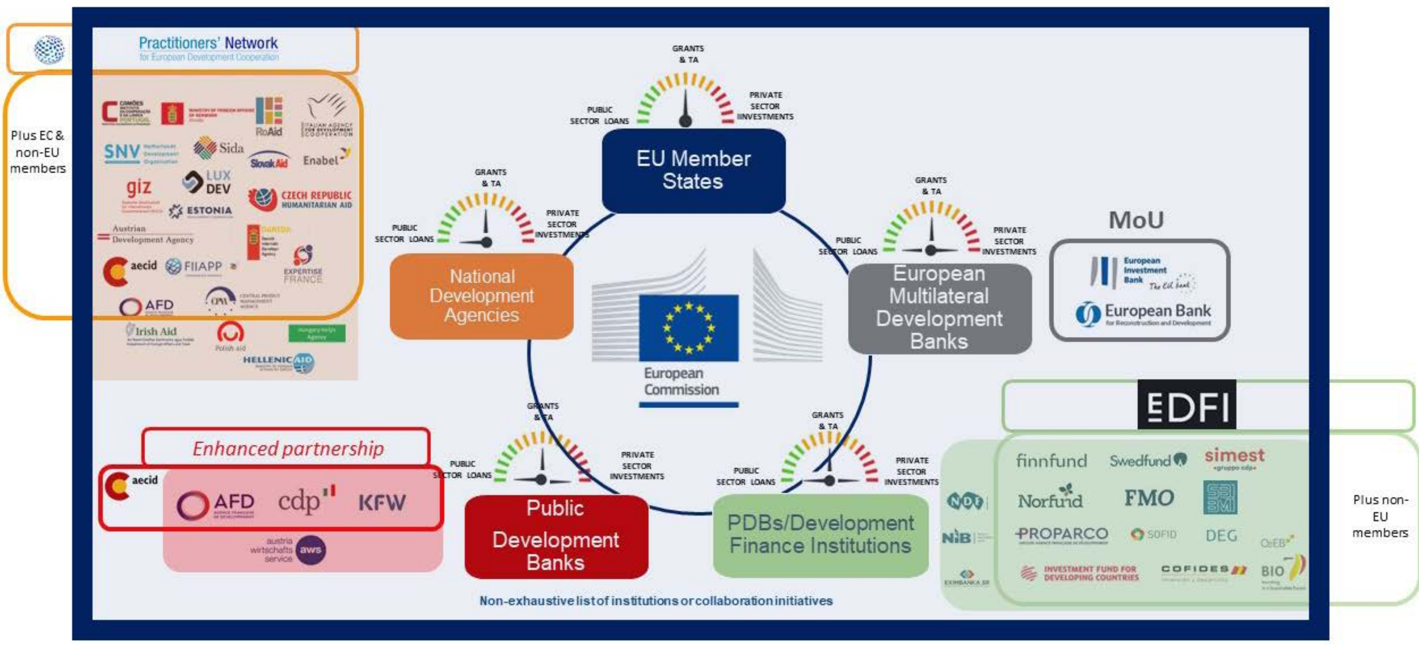
Development cooperation and development finance frameworks have experienced a systemic shift in the last decade. Today, we are more acutely aware of the critical role that private finance and the private sector can play in promoting structural transformation and achieving the Sustainable Development Goals (SDGs). This shift is captured, among others, in the 2030 Agenda for Sustainable Development, the Addis Ababa Action Agenda on Financing for Development, the ambition to move 'From Billions to Trillions', the European Consensus on Development, and the emphasis on leveraging private finance.

In this context, the objectives of activities led by donors, implementing agencies and financial institutions for development – i.e., development finance institutions (DFIs) and public development banks (PDBs) – are increasingly aligned and intertwined. All these actors are seeking to contribute to the SDGs and the development of markets (BII 2022). They recognise the value of synergies between interventions and investments that target private sector development (PSD) (and the private sector for development). On one hand, PSD initiatives increasingly aim to attract private investments and work with DFIs or in-country investors to support thematic strategies. On the other hand, DFIs – through their investments – are seeking to deliver more sustainable impacts (geared towards economic transformation), to shape markets and be more active in least-developed countries (LDCs) and fragile contexts. In practice, this systemic shift is seen in several trends:

- more official development assistance (ODA) channelled through private sector instruments (OECD 2022);
- an increasing role of DFIs (which are focused on private sector operations) and PDBs (which focus on sovereign operations, including public-private partnerships) as development actors catalysing (private) finance (Marbuah et al. 2022, Prizzon 2021, Xu et al. 2020);
- a more prominent role of blended finance, in which DFIs and PDBs are increasingly involved (Attridge 2022, Bilal 2021a, C3 and Convergence 2022).

The European Union (EU) has been at the forefront of this global systemic shift. Building on the European Commission Communication A Stronger Role of the Private Sector in Achieving Inclusive and Sustainable Growth in Developing Countries and the EU External Investment Plan, which articulates a strategy of blended finance and guarantees combined with technical assistance and policy dialogue, the EU and its

Figure 1. Overview of the European financial architecture for development



Source: European Commission (2022).

> Donors, implementing agencies and financial institutions for development are increasingly aligned and intertwined. They all seek to contribute to achieving the SDGs and the development of markets. They also recognise the value of synergies between interventions and investments that target the private sector for development. Building on the Team Europe and 'Working Better Together' approaches, the 'policy-first' principle, and European values and objectives, the EU is at the forefront of this endeavour, giving new impetus to coordination efforts to take full advantage of its budgetary and policy frameworks, with a view to strengthening the European (financial) architecture for development.

individual member states aim to better harness the potential of their financial institutions for development (DFIs and PDBs) (Bilal 2021a, Bilal 2022). They recognise that implementation of the current European architecture for development requires better and more systemic coordination and cooperation between donors, implementing agencies and financial institutions for development, on blended finance and beyond, to catalyse private initiatives and finance at scale and for greater impact. The EU and its member states are therefore engaged in a process of strengthening the European financial architecture for development (EFAD), entailing better coordination not only among development financiers but also with development actors (Figure 1) (Bilal 2021b, European Commission 2022, Gavas and Pérez 2022).

The drive for better coordination between European donors, their development agencies and financial institutions for development, including the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD), is not new. In its COVID-19 pandemic response, the EU renewed political and practical impetus for coordination along three major axes of 'Global Europe', the EU's external action financing framework for 2021-2027:

Implementing an effective Team Europe approach.

The principle of Team Europe is to bring together EU institutions and member states, their development agencies, and financial institutions for development, for greater coherence, synergy and impact of collective European development endeavours (Jones and Teevan 2021, Keijzer et al. 2021). The Team Europe approach is promoted and generally steered by the European Commission and at the local level by the EU delegations in partner countries. The approach builds on the notion of 'Working Better Together', which promotes joint programming, frameworks and implementation for increased EU impact and influence (Sarazin 2020). Under the Team Europe approach, coordination between development actors, as promoted by the Paris Declaration on Aid Effectiveness, is not just 'nice to have' but a 'must'.

Strengthening the 'policy first' principle.

Under Global Europe and the European Fund for Sustainable Development Plus (EFSD+), financial institutions for development have to follow the 'policy first' principle set by the EU. This ensures that investments contribute to EU strategic policy objectives, development goals and values. It requires alignment of priorities and standards between the EU and its member states, and that these be reflected and implemented by beneficiary DFIs and PDBs.

Facilitating blended finance and guarantees, including in challenging markets.

One of the major objectives of the EFSD+, and of blended finance and guarantees more generally, is to promote investments at scale and in more challenging contexts, for greater development impact beyond the traditional reach of financial institutions for development. This requires coordination between donors, implementing agencies and DFIs/PDBs on the use of donor funding (e.g., investment grants and guarantees), the provision of technical assistance, and policy reforms and market development. Blending grants and other public finance for integral projects (e.g., infrastructure or coastal protection) with private financing from revenue-generating components of such projects can, moreover, lead to solutions that are more sustainable. Coordination and complementarity of interventions and instruments are especially critical in challenging environments, including poorer and more fragile contexts, where markets are not necessarily present or developed (Cusack et al. 2020, Attridge and Gouett 2021).

Yet, too often, European donor governments and their development agencies operate in parallel with their financial institutions for development or rely on standalone operations. The result is little or no synergy and cooperation between them, at the expense of overall development effectiveness. This raises the question of how coordination between the roles and activities of European donors, implementing agencies and DFIs/PDBs can best be incentivised, articulated and implemented in practice. This note presents insights drawn from the practical experiences of a range of European actors, including the EIB, EBRD, France, Germany, Italy, the Netherlands, Spain and the United Kingdom. Specifically, it synthesises lessons from case studies carried out by members of the European Think Tanks Group (ETTG) for the Practitioners' Network for European Development Cooperation.

LEARNING FROM PRACTICE

Institutional framework

Donors, implementing agencies and financial institutions for development operate within an institutional framework which sets the parameters for coordination between them, laying out what can be done and how coordination can be articulated. This institutional framework is influenced by history, culture, and legal and regulatory arrangements and is thus country- and EU-specific. This helps to explain why a variety of institutional architectures – more or less complex – exist across Europe.

Governments generally control their national development implementing agency and are direct shareholders in their DFI/PDB. This formal or institutional relationship is a necessary condition for donors to exert control over their DFIs/PDBs, but it is not sufficient to ensure coordination. It is the way coordination is articulated in practice that influences the degree to which donors and DFIs/PDBs cooperate – whether at arm's length through strategic directions or more closely through structured interactions. Beyond formal annual or biannual shareholder/policy meetings, some donors and DFIs, such as the Dutch entrepreneurial development bank FMO and Netherlands Ministry of Foreign Affairs, as well as the British International Investment (BII) and the UK Foreign, Commonwealth and Development Office (FCDO), organise working groups to exchange knowledge and expertise on specific issues, such as fragile contexts and countries. The relationship between implementing agencies and DFIs is generally less institutionalised and tends to happen more on an ad-hoc basis – exceptions being the Agence Française de Développement (AFD), which has close interactions with the DFI Proparco through a monthly investment advisory committee (in addition to quarterly strategic meetings), and the particular case of Spain, where the FONPRODE financial cooperation fund is embedded within the development agency itself, Agencia Española de Cooperación Internacional para el Desarrollo (AECID). Furthermore, Germany's experience suggests that coordination between key cooperation actors is likely to increase in areas that are prioritised in government development policy, such as climate action. Such 'case-by-case' coordination efforts may prepare the ground for needed systemic reforms.

Beyond the strategic level, donors, implementing agencies and DFIs/PDBs also cooperate at a more practical (and sometimes ad-hoc level), through specific joint projects or funds, platforms and structures. An example is the Dutch Fund for Climate and Development (DFCD) in which FMO works together with the Netherlands Ministry of Foreign Affairs, the Dutch agency SNV and other non-state actors to implement investments in climate mitigation and adaptation. Similarly, BII and FCDO work together through the dedicated platform Invest for Impact Nepal (IIN). Such cooperation is an operational vehicle for closer alignment of the activities of donors, implementing agencies and DFIs.

Coordination can also take place between development finance, foreign policy and economic interests, to share information and promote sustainable in-country investments. Such coordination often falls within four categories:

LDCs and fragile contexts.

Coordination allows for management of not only financial risks, but also security, political and reputational risks, in case of unfortunate events and operational failures (which are more likely in fragile contexts). This requires a more politically savvy and coordinated approach by DFI/PDBs, implementing agencies and donors. The FISEA(+) facility, a €210 million investment capacity for African micro, small and medium-sized entrepreneurs (MSMEs), implemented by Proparco in collaboration with AFD, is a case in point, as its governance structure includes a dedicated space for discussion and decision-making. The same is true of the IIN, which involves FCDO, BII, FMO and the Swiss Agency for Development Cooperation (SDC).

Market shaping and development.

Another reason to engage jointly is to better connect the private sector, economic opportunities and interests. This is an objective of IIN, for instance, as its platform focuses both on supporting the development of BII's investable pipeline of projects and investee companies, and broader market shaping activities in which FCDO has a prominent role. It is also the case for FISEA+.

Project pipeline development.

In challenging market contexts, bankable projects can be rather limited, constraining DFI investments. This incentivises DFIs to work with donors and their implementing agencies, as they can provide technical assistance to project promoters and support the investment climate. DFCD, for example, relies on SNV and a civil society organisation (CSO), the World Wildlife Fund (WWF), to source projects and help make them bankable, so that FMO and DFCD can invest.

Joint evaluations and standards.

Impact monitoring and evaluation is an area often targeted by donors, implementing agencies and DFIs/PDBs for coordination. Shared evaluation approaches and standards can be informed by work such as the Blended Finance Principles Guidance and the Impact Standards for Financing Sustainable Development, developed by the Organisation for Economic Co-operation and Development (OECD) and United Nations Development Programme (UNDP).

Levels of coordination

The ETTG case studies show that coordination between donors, implementing agencies and DFIs/PDBs takes place at multiple levels, though these are not mutually exclusive. Coordination occurs at the headquarters and partner country levels and in relation to specific joint projects, but it can also arise on a more ad-hoc and opportunistic basis (Figure 2).
Figure 2. The main levels of coordination between donors, implementing agencies and DFI/PDBs

Headquarters level. Most coordination at the headquarters level focuses on strategic issues, high-level priorities, and institutional frameworks and processes, without necessarily involving donors or implementing agencies at the operational level. Such coordination is particularly relevant for DFIs with limited in-country presence. Examples are the EIB trust funds and EBRD multi-donor funds. Donors can invest in these directly, following a dialogue aimed at aligning donor priorities and requirements with those of the DFI. At the EU level, the European Commission, together with the European External Action Service (EEAS), plays a catalytic role in such coordination, under the strategic and operational guidance of the EU member states, as in the case of the EFSD+.

In specific partner countries. Coordination within partner countries enables donors, implementing agencies and DFIs to work closer together on operational matters, towards strategic objectives. For instance, the IIN platform provides a key setting for DFIs and donors to dialogue on important issues, establishing a basis for a common voice. In fact, the platform has become the 'go-to' place for donors and DFIs interested in working together to increase private investment towards economic development goals in Nepal. Another example, related to the Team Europe approach, is the central role played by the EU delegations in partner countries in stimulating and facilitating coordination between the EU institutions, EU member states and their financial institutions. Similarly, the EIB has increased its local presence in partner countries in synergy with, and often hosted in, EU delegations.

Figure 2. The main levels of coordination between donors, implementing agencies and DFI/PDBs

In specific joint projects. Coordination at the programme level (through funds) and at the level of joint projects is particularly valuable in increasing opportunities for knowledge sharing, including through informal channels. For instance, SNV and FMO work together to cover the entire investment project lifecycle – from identifying potential projects, to developing them and investing in them. Likewise, AFD and Proparco cooperate through the FISEA+ facility to invest in micro, small and medium-sized enterprises in fragile contexts. Though Proparco has limited in-country presence, working with AFD allows it to feed its insights to the local level, which can help shape more impactful investments.

Local level. Coordination does not necessarily have to be high level and structured. It can also emerge on an ad-hoc or opportunistic basis as opportunities or challenges arise. These experiences should not be overlooked, as they can lay the groundwork for more structured forms of coordination, if sufficient flexibility is available. Such an evolution is very dependent on the institutional framework discussed earlier. The Team Europe approach, facilitated by the European Commission and EU delegations, seeks explicitly to foster opportunities for ad-hoc coordination that can lead to development of more systemic approaches.

1. OBJECTIVES OF COORDINATION

Coordination can serve various objectives: providing donors, implementing agencies and DFIs/PDBs access to complementary resources and tools; paving the way for a more comprehensive and synergistic approach; and offering a platform for addressing common issues together.

Complementing resources and tools for impact

- Optimising the use of technical assistance, including linking capacity building to development finance
- De-risking public and private investments by leveraging donors' guarantees and other financial instruments
- Beyond tools, pooling together a unique set of knowledge, expertise and resources

Optimising the use of technical assistance (TA).
Donors, implementing agencies and increasingly DFIs are implementing TA programmes, which can be of prime importance in making projects investment-ready and in mitigating risks – both financial and technical. In this sense, the lines between the engagements of DFIs and implementing agencies are gradually blurring. This has only added to the need for greater attention to coordination and joint action. Coordination between donors, implementing agencies and DFIs/PDBs can help streamline and mainstream TA programmes, connect TA programmes better to concrete investment opportunities and financing operations, and leverage the actors' respective expertise, knowledge and experience (Gavas and Pleeck 2022, European Commission 2022). EIB trust funds, for instance, allow donors to provide TA funding for specific strategic priorities and countries. In Germany, the case of the Agency for Business and Economic Development demonstrates how TA can target the domestic – in this case German – audience, as the Agency facilitates the use of various private sector initiatives by the intended actors.

De-risking investments by leveraging donor guarantees and other financial instruments.
Besides technical assistance, donors can provide DFIs/PDBs with (first loss) guarantees to incentivise them to invest in challenging markets and issues of strategic priority for donors. As DFI/PDB investments need to combine financial and development objectives, these institutions are constrained in their ability to invest alone in particularly complex or risky contexts – despite potentially high development impacts. Stronger coordination between donors and DFIs/PDBs can help de-risk public and private investments, while helping to ensure that investments contribute to both EU development policies and partner country needs (Bilal 2021c). Yet, unlocking the development potential of risk-sharing mechanisms and revised risk tolerance may also require innovating and adapting financial tools and business models, departing from business as usual – without overlooking market-building objectives. For instance, the French Ministry of Foreign Affairs provided a grant to the FISEA(+) facility to cover potential risks associated with future operations. This allowed the facility to invest in companies based in more challenging environments. Due to the financial risks involved, this would have been impossible without the grant.

Pooling together a unique set of knowledge, expertise and resources.
Donors, implementing agencies and DFIs/PDBs each bring different yet complementary expertise and knowledge – e.g., in investment, financial engineering, economic transformation and market development. Donors, moreover, tend to have extensive networks of public sector actors and CSOs, while DFIs' networks often focus on the private sector, both financial and non-financial entities. Sharing their networks gives donors,

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implementing agencies and DFIs/PDBs access to a wider scope of relevant actors, bringing new opportunities and knowledge. The knowledge and networks of local CSOs can be particularly relevant, though many CSOs continue to operate solely as grant-making organisations, without a social enterprise mandate. Nonetheless, having a well-connected social enterprise as part of a partnership (e.g., a consortium) with donors and DFIs can be of great benefit for private investments to positively impact climate, sustainability and inclusion. Transformation of CSOs so they can also operate as social enterprises should therefore be supported. Lastly, partnering with donors (embassies and EU delegations) and with implementing agencies, as well as with local actors, can enable DFIs/PDBs to tailor their operations further to the local context – despite their own often limited in-country presence (with the notable exception of AFD). The case of Germany demonstrates the benefits of investing in shared partner country representations. Another example is DFCD, in which SNV plays a key role in linking with local knowledge and stakeholders, as well as flagging environmental and social risks that could arise from financed operations.

Paving the way for a more comprehensive and synergetic approach

- Adopting a comprehensive approach to investment, including a combined public and private financing of integral projects
- Linking projects and shifting from project to systemic impacts
- Enabling 'escalator' or 'cascading' engagement to shape markets

Adopting a comprehensive investment approach. Coordination between donors, implementing agencies and DFIs/PDBs allows financing to be combined with technical assistance and policy dialogue in a structured fashion, thus connecting investment support with policy reforms and institutional development. This approach – embedded in the EBRD business model and highlighted in the EU External Investment Plan (EIP) – is increasingly being put into practice, particularly in the context of 'escalator' or 'cascading' models of engagement. For example, Germany's procedural reforms towards integrated planning and allocation systems for technical and financial cooperation are creating a means for the government to articulate its substantive goals in consultation with all relevant actors, while simultaneously promoting and monitoring joint action. Unfortunately, community engagement, although crucial, is still not a standard element in the process of implementing public and private investments. Insufficient attention to relations with local communities and stakeholders is all too common.

Linking projects and shifting from project to systemic impacts. Some DFIs/PDBs tend to focus solely on identifying investable individual projects, with too little consideration for systemic impact and overall contribution to inclusive and sustainable economic transformation. Collaboration with donors and implementing agencies opens the door to a better linking of projects and a shift from project impact to systemic impact, aligned with the SDGs (Riaño et al. 2021). For instance, in the DFCD case, SNV identifies innovative projects that can contribute to systemic impacts. These can then be further developed into investable projects and financed by FMO. This process also helps anchor development finance projects within the local context.

Adopting an 'escalator' or 'cascading' model of engagement to shape markets. In an 'escalator' or 'cascading' model of engagement, donors get involved first in given sectors and countries to help lay the foundation for market development, a sound regulatory environment and a conducive entrepreneurial ecosystem. Then DFIs/PDBs engage to help shape markets and support sustainable investment. Note, however, that the example of the IIN indicates that, to be effective, DFIs generally need to be involved right from the start, to ensure the platform is investment-focused and help dispel unhelpful preconceptions. The EBRD model and EIB experience, along with the 'policy first' principle, confirm the need for early-stage involvement for effective escalator or cascading engagement.

Working towards specific common issues

- Developing a pipeline of bankable projects
- Ensuring solid impact reporting
- Enabling DFIs/PDBs to be responsive in times of crisis

Developing a pipeline of bankable projects.
Lack of bankable projects is a major barrier preventing DFIs/PDBs from investing. It especially affects DFIs/PDBs that aim to operate in more challenging markets or target micro, small and medium-sized entrepreneurs (MSMEs) and young businesses. Developing a pipeline of bankable sustainable projects requires specific upstream investments. These may, depending on the circumstances, justify dedicated support from donors and development agencies, possibly through DFIs/PDBs. Addressing this issue requires a comprehensive approach focused on building local capacities, adapting the regulatory framework and supporting the business environment (entrepreneurial ecosystem and infrastructure), which are typically part of donors' and implementing agencies' PSD interventions (Tyson 2018, Dalberg 2021). An example is DFCD, in which SNV provides technical assistance to project promoters, with a view to developing projects that FMO can invest in. In this case, FMO worked together with SNV beforehand to establish a common understanding of what a bankable project is.

Ensuring solid impact monitoring and reporting.
DFIs/PDBs, as development actors, need to follow the Busan principles for effective cooperation, including on accountability. By leveraging donor experiences in monitoring and evaluation (M&E) they can be more successful in capturing all relevant impacts (OECD and UNDP 2021, PublishWhatYouFund 2020). It is essential to develop clear and, if possible, quantifiable, transparent and common (or comparable) yardsticks to measure and report on DFI/PDB operations and their impact. In doing so, DFIs/PDBs need to collaborate not only with each other but also with the broader development community, particularly donors with a good track record in this field. Beyond the Busan principles, reporting standards need to reflect due diligence and be in line with the Paris Agreement; the SDGs; human, social and labour rights; and gender equity. It is also important to keep in mind the cost-effectiveness principle of monitoring and evaluation (M&E) and what DFIs may reasonably expect from their clients, building on the private sector's own processes. The aim should be efficient M&E and reporting approaches that are coherent among development actors.

Enhancing the capacity of DFIs/PDBs to respond in times of crisis.
In a world that is increasingly fragmented, unpredictable and subject to unprecedented climate disasters and international tensions, financial institutions for development need the capacity and ability to react quickly and at scale. Coordination between donors and DFIs/PDBs is crucial to ensure that DFIs can respond to donors' geostrategic priorities.

2. CHALLENGES

To realise coordination objectives, donors, implementing agencies and DFIs/PDBs must overcome several types of challenges.

Institutional and legal challenges

- Asymmetry in objectives and incentives
- Lack of geographical, thematic and sectoral alignment
- Differences in legal frameworks
- Asymmetry in size and power relations

Asymmetry in objectives and incentives.
Whereas donors and implementing agencies are more policy-driven, working upstream and also pursing policy goals through their interventions, DFIs tend to follow a market-led approach, responding to private sector needs with a financial lens. As for-profit development-oriented organisations, DFIs/PDBs focus on (i) providing market rates of return on investments, in addition to generating positive development impacts; (ii) maintaining high credit ratings (AAA); and (iii) ensuring performance at the transaction level. In contrast, donors and implementing agencies often rely on grants, which do not require a financial return; and they are more concerned with sector performance

and sustainable development impacts than with market returns and leveraging additional finance. These differences, often enshrined in their respective institutional and legal frameworks, translate into the use of different means, tools, incentives, priorities and interests, making it challenging to work towards a common agenda. This is illustrated by the IIN platform, in which both DFIs and donors have had to make trade-offs to work together effectively.

Lack of geographical, thematic and sectoral alignment.
Because of their different objectives and incentives, donors and DFIs/PDBs do not necessarily operate in the same countries, sectors and issues. DFIs tend to be more active in markets where they can identify and reliably implement bankable projects, which often diverts them away from investing in LDCs, fragile states, social sectors and themes such as climate adaptation and support for early-stage innovation. On the other hand, donors and implementing agencies, which are not concerned with returns on investments, can more easily operate in these challenging markets. This makes coordinated initiatives involving donors, implementing agencies and DFIs/PDBs more demanding to establish and operate, as some actors may be required to enter new markets. In Spain, for example, the main partner countries for FONPRODE engagement (Cambodia, Bangladesh and South Africa) did not coincide with the priorities set in the master plan for Spanish development cooperation and, therefore, fell outside the technical cooperation focus of the AECID and International and Ibero-American Foundation for Administration and Public Policies (FIIAPP).

Differences in legal frameworks.
Beyond the institutional framework, the legal framework can sometimes complicate collaboration involving donors, implementing agencies and DFIs/PDBs. For instance, the legal status of most implementing agencies prohibits them from making profit. They are incentivised to spend their aid budget to foster development, but cannot receive fees or proceeds in return. This was an issue in the DCFD case, as SNV could only provide grants for technical assistance to make projects bankable; it could not explore more innovative (revolving) instruments, such as convertible grants, given its legal status and the underlying preclusion of profit-making. This raises questions regarding DCFD's financial sustainability. Difficulties associated with legal frameworks can materialise in other ways as well. After the Great Recession, it became forbidden in Spain for FONPRODE to engage in non-reimbursable financial cooperation, thus severely limiting any possibility of blending or working more closely with technical cooperation. To facilitate coordination, donors, implementing agencies and DFIs/PDBs may need special arrangements and mechanisms, such as revolving funds and convertible grants.

Asymmetry in size and power relations.
Interactions between donors and DFIs/PDBs can be affected by power asymmetries and concerns about independence. Who leads whom, and respect for decision-making autonomy can then become issues. The 'policy first' and political drive of some donors may be difficult to align with the market-driven approach often followed by DFIs. Some development institutions, too, are highly focused on their own visibility and profile, which limits de facto opportunities for coordination and cooperation. The Team Europe approach is an example in which joint action is stimulated without losing the independent profile of each contributor.

Challenges relating to resources and capacities
- Different languages and capacities, and insufficient interconnections across networks
- Different tools and resources
- Additional time and resources spent
- Lack of local presence of DFIs

Different languages and capacities.
Reflecting their core business, donors and implementing agencies often have solid technical knowledge of development processes and sustainability, while DFIs/PDBs have strong financial and banking expertise. Each has its own competencies and specialisations, which could however, make it difficult for them to speak the same language. Donors and implementing agencies tend to emphasise sustainable development impact, while DFIs and PDBs give greater attention to market conditions and distortions and financial sustainability. For instance, in the DFCD case, FMO had to work together with SNV and WWF to establish a common understanding of what a bankable project is. Furthermore, donors, implementation agencies and DFIs/PDBs tend to engage in different networks with different types of actors, which may not be interconnected.

Different tools and resources.
Donors, implementing agencies and DFIs use different tools – such as grants versus financial instruments – and they often have limited awareness and understanding of the resources of the other. This can impede opportunities for coordination and synergies. Too often, technical assistance is designed as a standalone operation, with no direct connection to financing foreseen (e.g., training for smallholder farmers linked to a microfinance operation to provide funding). For instance, in

Spanish development cooperation, FONPRODE's narrow focus on microfinance has hampered coordination with technical support in certain sectors. In addition, as noted, the different actors tend to move in separate worlds. Their own networks exist independently of one another, limiting opportunities for interaction and coordination. DFIs are more connected to private sector actors, while donors and implementing agencies are more engaged with public authorities and civil society. This may particularly hinder opportunities for in-country types of coordination.

Additional time and resources spent.
Making coordination work requires engagement, which necessarily translates into additional expenditures of resources and time. This may disincentivise donors, development agencies and DFIs/PDBs from engaging in a coordinated endeavour. They need to justify the extra resources and time without necessarily knowing in advance what impacts will arise. Coordination also requires additional effort and 'out of the box' thinking, as it is not usually part of standard processes.

Lack of local presence of DFIs.
Unlike donors and implementing agencies, most DFIs, because of their institutional setting and the nature of their work, have a limited in-country presence. Most of their operations are conducted at the headquarters level, based on information provided by project promoters, supplemented by staff missions when necessary, or inputs from local offices where these are present. This naturally limits opportunities for in-country coordination. Spanish cooperation delegations (called OTCs), for example, engage only with technical cooperation counterparts and do not interact with delegates of financial cooperation institutions.

Challenges related to processes

- Differences in procedures and speed
- Different time horizons
- Linking technical assistance to investments, avoiding tied aid
- Lack of attention to local ownership and capacity building of the local ecosystem

Differences in procedures and speed.
From the perspective of many DFIs, donors tend to have too many requirements and detailed procedures in terms of conditionalities, criteria and reporting. These can considerably slow DFI processes and make private transactions cumbersome and more costly. This can affect the ability (and added value) of DFIs in responding to private sector needs. DFI operations sometimes also require flexibility and adjustments from donors and implementing agencies, to reflect challenges faced on the ground.

Different time horizons and requirements.
DFIs and donors often have different time horizons. DFIs typically tend not to invest if there is not a strong pipeline of bankable projects and an adequate regulatory framework. Yet, without a DFI commitment to invest, donors are less likely to support the development of bankable projects.

Linking technical assistance to investments, avoiding tied aid.
European donors and implementing agencies attract and create considerable expertise and technical knowledge. Yet, while donors can provide grants for technical assistance to support DFI/PDB operations, aid cannot be tied in any form, even to link their own expertise and technical assistance to DFI/PDB operations. As for DFIs/PDBs, they must follow open public procurement rules. The challenge is thus for DFIs/PDBs to benefit from relevant technical expertise and actions of donors and implementing agencies while sourcing relevant expertise for their projects from the market. This also indicates the scope for coordination between DFIs and implementation agencies to go beyond technical and process-related exchanges to include substantive discussions and joint learning. Interesting settings for this are institutional rapprochement, as in the case of France with AFD and Germany with BMZ, GIZ and KfW, as well as multi-annual donor engagements with expert institutions – including CSOs – as in the Netherlands with institutions such as SNV, Agriterra, Solidaridad and IDH. Better cooperation and coordination can lead to enhanced synergies between the TA programmes of donors and expert institutions and the financing operations of DFIs/PDBs. An illustrative example is the partnership between the EIB and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) (EIB 2022).

Ensure local ownership and contributions to build local ecosystem capacity.
A main challenge affecting coordination between donors, implementing agencies and DFIs/PDBs remains failure to include local stakeholders in the cooperation framework. Particularly, there has been a lack of capacity building of local project promoters and the entrepreneurial ecosystem. Strengthening these, however, is key to ensure that future technical assistance can be sourced locally, without involvement of international organisations. To overcome this challenge, in the DFCD case, SNV works to build the capacities of local cooperatives, which then provide support to smallholder farmers.

3. RECOMMENDATIONS

1. Identify clear, pragmatic and achievable cooperation objectives, focused on a few core initial objectives

Coordination between donors, implementing agencies and DFIs/PDBs should be seen as a gradual and incremental process, in which each step contributes to achievement of the next. Rather than 'aiming for the moon', donors, implementing agencies and DFIs/PDBs should identify clear low-hanging fruit cooperation articulated around a limited number of shared objectives to get coordination started. Often, these low-hanging fruits are identified following a bottom-up approach and allow the involved actors to demonstrate that coordination can work in practice. As needs evolve, the coordination can evolve towards one that is more formalised and ambitious in terms of strategic objectives and coordination mechanisms (but also more resource intensive).

2. Focus on alignment of key objectives and incentives, based on simple processes (avoid complexity and bureaucracy)

A top-down approach can be useful for identifying areas where incentives align and hence where synergies between donors, implementing agencies and DFIs/PDBs are most likely to happen in practice. This may mean striking compromises to find common ground where there is mutual interest and complementary expertise and capabilities. Importantly, coordination should be pursued from the start of market-shaping activities, to ensure they facilitate stronger engagement of DFIs as market conditions improve.

When operationalising coordination, it is important to keep governance and implementation processes as simple as possible, to maximise flexibility, responsiveness and efficiency. Donors, implementing agencies and DFIs/PDBs need to focus on streamlining governance mechanisms so they are fit to deliver on their strategic goals – towards the end objective. This will also help avoid any sense of fatigue from the different institutions engaged in the coordination. Appropriate internal incentives to facilitate and reward cooperation efforts also need to be in place.

3. Meet on a regular basis (formally and informally), and support secondment opportunities, to better know and understand each other and build trust

To address the language and culture barriers, donors, implementing agencies and DFIs/PDBs should engage in closer dialogue to exchange views, knowledge and expertise on shared challenges and issues and promote mutual networks via secondments. This dialogue does not necessarily need to be institutionalised – in fact, informal dialogue (including corridor talks and informal meet-ups after work) can play a key role in building trust and facilitating a common understanding of particular issues. In addition to dialogue, secondment in each other's institutions (as in the case of the EBRD, EIB and IIN platform) is an effective way to both build a common culture and language and influence strategic and operational activities, injecting new ideas and ways of thinking.

4. Donors do not need to lead the coordination. While their strategic steering is important, they can support (rather than lead) on operational matters, with DFIs/PDBs and implementing agencies playing a key role

Donors can work with DFIs/PDBs or incentivise coordination between DFIs/PDBs and implementing agencies (and other non-state actors), but they should refrain from necessarily positioning themselves in the driver's seat of the coordination. While donors should give strategic directions in line with their policy objectives (such as 'policy first') and can provide on-the-ground support through their embassies and EU delegations, they do not need to be closely involved in day-to-day operations. Instead, their added value often lies in their ability to discuss and respond quickly to challenges arising from the operational activities of DFIs/PDBs and implementing agencies in the local context.

5. Allow for trial and error, innovation and pilot initiatives, then scale up and replicate successes

Practice shows that coordination is anything but a linear process. It is built in iterative cycles of learning and adaptation as opportunities and challenges arise. For donors, implementing agencies and DFIs/PDBs, this points to the importance of allowing for trial and error and leveraging small-scale pilot initiatives to gain experience and draw lessons. Especially useful in this process is noticing what works and what doesn't, and why. This can, in turn, help in scaling up and replicating successful approaches, which will need to be tailored to the country and sector of operations and the types of actors involved ('one size fits all' will not work). Importantly, donors, implementing agencies and DFIs/PDBs should be ready to spend additional resources on these types of exercises.

6. Adopt a long-term approach, aiming to shift from ad-hoc coordination to more systemic cooperation

Coordination is a process requiring time and financial resources, and is best achieved with a long-term approach – especially in contexts where there is limited dialogue and experience in coordinating or where ambitions are high. Another requirement is flexibility, to allow for adaptations to both actors' capacities and the local context – which may prove more challenging than anticipated. In the DFCD case, for example, it took more than two years to 'graduate' the first bankable projects to FMO and fund managers, though a tighter timeframe was initially foreseen. Also in this case, working with the DFI has expanded the implementing agencies' capacities and knowledge. They now provide greater added value to DFCD and beyond. Finally, adopting a long-term approach to coordination requires involvement of higher political levels. In Spanish cooperation, very little technical-financial coordination was observed, likely reflecting a need for a more strategic or political vision on the importance and benefits of closer coordination.

7. Consider including other actors (e.g., the private sector, non-governmental organisations and local counterparts) in coordination involving donors, implementing agencies and DFIs/PDBs, and promote adaptation and transformation

Opening up a coordination exercise beyond donors, implementing agencies and DFIs/PDBs can be a practical way to anchor investments in the local context, mobilise private capital for sustainable development, and engage in the 'Team Europe' and 'Working Better Together' approaches. A wider spectrum of actors can also support more comprehensive and inclusive sustainable adaptation and transformation of entrepreneurial ecosystems and of actors' approaches and capacities.

In the DFCD case, FMO chose to work with SNV and WWF, both organisations with strong technical knowledge, including on climate adaptation, and strong in-country presence and networks. But it also partnered with financiers (an investment fund, commercial banks and pension funds) to mobilise private sector investment, and with local counterparts such as cooperatives (through SNV) to build local ecosystem capacity and strengthen knowledge of the local context.

8. Build on the 'Team Europe' and 'Working Better Together' approaches, pulling other donors and DFIs/PDBs into successful partnerships, including through local platforms

Moving forward and following the Team Europe and Working Better Together approaches, it is important to consider the benefits of enlarging coordination endeavours beyond a single EU member state institution and pulling in other donors and DFIs/PDBs with aligned objectives, as relevant. Importantly, coordination spanning multiple donors and DFIs/PDBs should be based on simple and harmonised procedures to avoid additional requirements and bureaucracy that make the coordination process sluggish and overly resource-intensive.

The EIB Partnerships Platform for Funds (PPF), for instance, gives donors the opportunity to jointly finance technical assistance and provide investment grants and guarantees, alongside other instruments tackling specific regions, sectors and themes. By joining these initiatives, donors can add their weight to help scale up EIB activities in accordance with their own strategic priorities. Similarly, in the DFCD case there is potential to involve other donors and local counterparts, to further advance the development of bankable projects tackling climate mitigation and adaptation in LDCs. The DFCD approach could also be enriched by replicating some of the features of the IIN platform at the national level.

9. Foster standardised and simple procedures and M&E processes, avoiding procedural over-burdening

Developing streamlined and simplified procedures and monitoring and reporting requirements greatly facilitates coordination. Donors should increasingly consider alignment and harmonisation in this respect, to avoid procedural over-burdening. For instance, when the EIB streamlined its trust fund framework in harmony with the PPF, the number and volume of trust funds increased. Existing donors found it relatively easy to engage in the different funds, as they were already familiar with the rules and M&E framework.

10. Engage in peer reviewing, lesson sharing and critical assessment

Donors, implementing agencies and DFIs/PDBs should invest resources in sharing experiences and in peer reviewing their coordination initiatives, tracking the progress achieved, analysing bottlenecks and drawing lessons. The objective is to build knowledge and stimulate the uptake of innovative approaches.

The EU institutional setting and current process of strengthening the European financial architecture provide a conducive environment to foster coordination between European donors, implementing agencies and DFIs/PDBs, in synergy with other relevant stakeholders at the EU and member state levels (e.g., the private sector, civil society, local actors, international institutions and partner countries). The European Commission, together with the Council, can play a catalytic role in stimulating improvements in the coordination framework. It can, for example, propose innovative approaches, initiatives and coordination mechanisms and promote lesson sharing and adoption of better practices, as highlighted in the recommendations enumerated above. EU actors can contribute by taking advantage of and building on the Team Europe and Working Better Together approaches and existing coordination groupings, examples of which are the Practitioners' Network for European Development Cooperation, the Association of European Development Finance Institutions (EDFI) and the Joint European Financiers for International Cooperation (JEFIC), which is the network of European bilateral banks and financial institutions, including AECID, AFD, CDP and KfW. The EU should also build on and better connect with donors and implementation agencies, and engage with the various institutional frameworks for development finance, such as the EFSD+ Strategic and Operational Boards and the Board Advisory Group on the EIB's Global Operations. Furthermore, there is a need for active EU interaction with the boards of the various international financial institutions to which EU member states belong, particularly the EBRD. In this regard, the European Commission could consider reviving and reforming strategic platforms, such as the EU Platform for Blending in External Cooperation (EUBEC), bringing in the relevant stakeholders. ■

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