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A LITERATURE REVIEW ON THE ADDITIONALITY OF USING ODA TO LEVERAGE PRIVATE INVESTMENTS

CONTENTS

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ACRONYMS

AsDB	Asian Development Bank
AfDB	African Development Bank
BIO	Belgian Investment Company for Developing Countries
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
ECA	European Court of Auditors
EIB	European Investment Bank
FinnFund	Finnish development finance company
FMO	Entrepreneurial development bank of the Netherlands
IADB	Inter-American Development Bank
IEG	World Bank's Independent Evaluation Group
IFC	International Finance Corporation (a member of the World Bank Group)
KfW	German development bank
LDC	Least Developed Country
LIC	Low Income Country
MDB	Multilateral Development Bank
MIC	Middle Income Country
MIGA	Multilateral Investment Guarantee Agency
Norad	Norwegian Agency for Development Cooperation
NorFund	Norwegian Investment Fund for Developing Countries
ODA	Official Development Assistance
OECD-DAC	Organisation for Economic Cooperation and Development – Development Assistance Committee
OeEB	The Development Bank of Austria
OPIC	Overseas Private Investment Corporation (USA)
PIDG	Private Infrastructure Development Group
PPP	Public-Private Partnership Corporation for International Investment
SIDA	Swedish International Development Cooperation Agency
SwedFund	State owned risk capital company (Sweden)
TA	Technical Assistance

EXECUTIVE SUMMARY

There is a great deal of focus at the moment – political, technical and from a variety of development actors – on the potential for ODA to be used to catalyse substantial and additional resources for development. Additionality is thus a crucial criteria and determinant in projects using ODA to leverage private investments. Unless it can be proven that ODA funds are necessary to a) make to the project happen and/or b) increase the development impact of projects, then they are simply displacing other actors who could provide finance and unnecessarily subsidizing private sector investments. This reports reviews existing literature on the additionality of development projects using official development assistance (ODA) to leverage private sector investments for development. It focuses on both financial and development additionality.

The report finds that there is very little evidence about the additionality of leveraging projects. This applies to both financial and development additionality. Firstly, there are not enough evaluations. This report has only identified a total of 19 evaluations and documents on the use of ODA to leverage private sector investments or comparable instruments and institutions. Secondly, there is no shared or common methodology and many reports do not use robust approaches to measure additionality. Moreover, the documents are often not very detailed and fail to identify the reasons behind different levels of performance.

Although evidence is weak, existing literature points to a number of factors that might have a significant impact on the additionality of leveraging projects. These factors are presented in tables 1 and 2 below. Additional research would be necessary to confirm whether these drivers do actually play a role.

Table 1: Drivers of financial additionality

Factor	Findings
Project design	Design of the project, especially financial aspects, has a significant influence over its additionality. Bias in the selection of companies and complex application mechanisms could also influence additionality
Countries	The choice of countries can have an impact on additionality. Generally higher in countries with underdeveloped financial systems
Timing	The earlier the institutions got involved in the project design the greater the chances to influence it
Focus on SMEs	There is some evidence that projects targeting SMEs could be linked with higher levels of additionality

Table 2: Drivers of development additionality

Factor	Findings
Standards	Projects have to adopt the standards of public financiers, but there is weak evidence about their actual implementation
Timing	The earlier the institutions got involved in the project design the greater the chances to influence it
Discovery	There is limited evidence of donors helping to identify new opportunities and markets for investors and using their contact networks to attract them
Spill-over effects	There are examples of legislative reforms carried out as a result of projects

This report also looks into two other questions where additionality has a direct and significant impact. It first analyses the relationship between additionality and leverage ratios and concludes that leverage ratios only make sense as long as additionality can be demonstrated. This conclusion also invalidates the use of leverage ratios as a proxy to measure financial additionality.

Secondly, the report looks at the relationship between additionality and development effectiveness principles. It concludes that additionality should play a significant role in assessing whether leveraging projects supported with ODA funds fulfil these principles. Depending on the specific principle, additionality should be seen as either a performance indicator or a necessary condition for compliance.

1 INTRODUCTION, KEY CONCEPTS AND METHODOLGY

This report reviews existing literature on the additionality of development projects involving the use of ODA funds to leverage private sector investments for development. The first chapter provides some basic background about the role of the private sector in development and introduces the main concepts and describes the methodology used in this report. The second chapter presents and discusses what existing literature can say about financial additionality. The third chapter focuses on development additionality. The fourth chapter examines the links between additionality and other aspects of the debate on the role of the private sector in development. The fifth and final chapter summarises the main conclusions of this literature review.

This report is based on desk research and the review of existing literature from a range of sources. A total of 19 relevant documents were identified. For more information, see the section on Methodology at the end of this report.

Basic background on the role of the private sector in development

In practice, the private sector has been an important part of development cooperation efforts for a long time. According to ActionAid (2014), there are three different ways in which donors can engage with the private sector. These categories do not have clear and well defined boundaries and there are projects that do not fit neatly in to one of them. Nonetheless, they are quite useful to illustrate different ways in which the private sector participates in development projects funded with ODA:

- **Delivering:** the private sector is an implementing partner in developing projects through procurement or the contracting of good and services (e.g. advisory services, infrastructure building, etc.)

- **Building:** domestic private sector is the intended beneficiary. The objective is to develop the local private sector though direct or indirect interventions which can take different forms including improving access to finance, developing skills, infrastructure development, policy development or legislative reforms. Direct in strategic sectors and companies can also fall within this category

- **Leveraging:** private sector is a partner in development. The objective is to increase the resources available for development by mobilising finance and investments from the private sector. Leveraging can happen at many levels (multinationals, companies from donor countries or developing countries, etc.) and take different forms (using ODA, public private partnerships-PPPs, etc.)

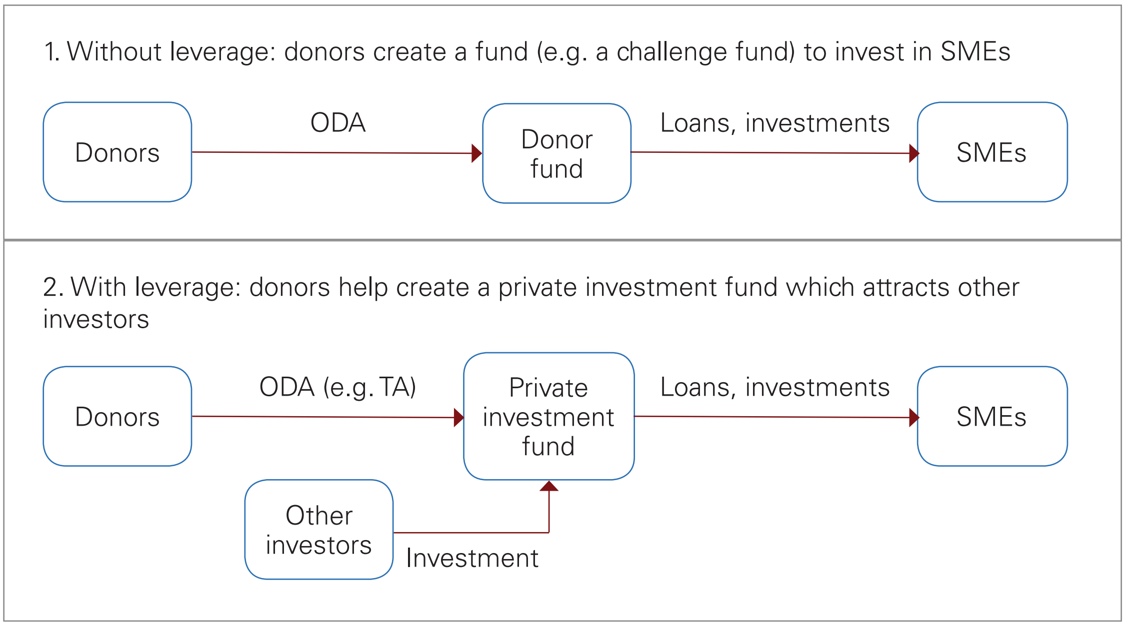
Comparatively and although the basic principles behind the idea of the leveraging have been around for some time, the interest in the concept has increased significantly among the development community since the late 2000s. Although it is not the intention of this report to explore the causes of this in detail, it is worth highlighting two important issues. On the one hand, traditional donors have been unable to meet aid commitments and the onset of the financial crisis in 2008 resulted in significant budget constraints which may have encouraged donors to increasingly look for new sources of finance. Secondly, and perhaps more importantly, around the same time and maybe for similar reasons, the existing discourse that considered aid and development assistance as the primary responsibility of governments has started to shift and become increasingly global.

A working definition of 'leveraging'?

Building on Brown and Jacobs (2011), this report defines 'leverage' as the use of public finance and risk mitigation instruments to remove the barriers to private sector investment in developing countries and thereby mobilise significant amounts of private capital for development. This definition above includes a potentially large number of public actors and instruments. In this report, we are only looking into the additionality of one specific source of public finance: official development assistance (ODA).

When conceptualising the idea of leveraging it is often useful to think about it as adding an additional step or stage compared to more traditional forms of ODA support to the private sector with the idea of generating additional funding. This is illustrated in the figure below with a fictional example.

Figure 1: Donors want to invest in SMEs in country X and set up a fund



What are the most common forms of ´leveraging'?

Using ODA to leverage private sector investments generally involves the use of ODA grants (including technical assistance) in combination with other sources of finance to create a leverage effect and attract additional capital. Table 3 below summarises the main instruments used to leverage finance using ODA according to the European Commission (2009) and indicates whether they are commonly used by donors.

Table 3 Main instruments to leverage private investments with ODA

Mechanism	Description	Use
Interest rate subsidies	Grant is used to cover part of the interest payments. The project promoter thus receives a subsidised loan below market interest rate	Frequent
Loan guarantees	Grant is used to cover the losses of the lender in case of default, so that it agrees to finance the project or to do so in better conditions	Frequent
Technical Assistance	Grant is used to provide specialised assistance during project preparation or implementation	Frequent
Structured finance – first loss piece	Donors offer finance with a lower repayment priority than the debt issued by other financiers. In case of default, donors would absorb the losses first	Less frequent, used by specialised DFIs mainly
Equity investment	A direct capital contribution is made to a company of investment funds, usually in order to send a signal to other investors or cover for first-losses and attract additional capital	Less frequent

What is additionality and why is it important?

In the context of this literature review, additionality can be broadly defined as the unique inputs and services that the use of ODA funds provides in addition to those delivered by market or nonmarket institutions (based on IEG, 2008). Thus, additionality represents the added value of using ODA compared to other sources of finance, in particular those available in the market. Unless donors can prove ODA funds are necessary to a) make to the project happen and/or b) increase the development impact of projects, then they are simply displacing other actors who could provide finance and subsidising private sector investments, which would result in a competitive advantage vis-à-vis other companies. Without additionality and an ability to demonstrate that additionality, aid is potentially being wasted.

Additionality can be broken down in different components depending on the specific area or aspect of the project which is affected. A number of authors use different components of additionality. In the context of this report, additionality has been broken down into two components:[1]

- **Financial additionality:** Would the private investment have happened anyway? Without financial additionality, instead of leveraging private finance by tackling existing barriers to additional investments, donors are simply displacing or crowding out private sector investors

- **Development additionality:** Would the resulting investment achieve better development results? Development additionality comprises other common components of additionality upon which it is based, such as design additionality (improved results as a consequence of better design features); operational additionality (specialized advice to compensate for knowledge and skills gaps among clients); and institutional additionality (improved standards of corporate governance, environmental and social sustainability, and regulation, and better public/private risk allocation). Development additionality does not include forms of additionality unrelated to development results such as corporate additionality (i.e. improvements in the corporate structure and management systems)

The different components of development additionality have been grouped together because i) there is not a consolidated definition or classification of additionality across existing literature; ii) there is not a lot of evidence on non-financial additionality and the analysis is more robust by adding them together; and iii) the idea of improved development results capture the other elements and is easier to understand in the context of ODA.

What are the main actors involved using ODA to leverage private investments?

Bilateral donors, in particular aid agencies which are the main source of ODA funds, have limited experience in the areas of private sector finance. As a result, they usually rely on the development finance institutions (DFIs), which include multilateral development banks and bilateral institutions such as DEG (Germany), Proparco (France) and FMO (Netherlands) to channel the funds and to screen and select candidate projects. For example, the European Commission's blending facilities bring together the European Commission as an ODA donor with a number of European DFIs. Individual DFIs screen and propose projects to the facility. These projects are jointly assessed by all members of the facility and the EC approves an ODA disbursement for the successful ones. The implementation and monitoring of the project is usually performed by the DFI.

2 REVIEW OF EVIDENCE ON FINANCIAL ADDITIONALITY

This chapter reviews the evidence available on financial additionality, discusses the methodology used to assess it and identifies existing data and research gaps. The definition of financial additionality can be found in the introduction.

Table 4 shows the documents on financial additionality that were reviewed in this report and summarises their main findings and features. It contains information for a total of 17 documents, although two of them have been aggregated due to their similarities. Some projects have been underlined to make it easier to follow the discussion in the section below.

Table 4 Literature review on financial additionality

Study	Financial additionality	Type of evidence and sample size	Why	Main instruments	Use of grants
Sjö and Ulväng (2008)	Limited: 8 out of 12 companies stated investment would have gone ahead anyway	Ex-post, 24 projects and review of number of companies	Timing of involvement, the earlier the better	N/A	No
IADB (2004)	Yes, but does not comply with definition	Ex-post, 55 projects	Better financial conditions and capacity to mobilise other finance	Loans	No
IADB (2014a)	Yes, but not compliant with definition. 82% of projects show some form of financial additionality: 43% better financial terms 38% resource mobilization	Ex-post, 141 projects	Better financial conditions and capacity mobilise other finance	Loans	No
BIO (2014)	Unclear because definition of satisfactory includes non-essential financial contribution. 14 excellent, 26 satisfactory, 5 unsatisfactory	Ex-post, 45 projects	Pioneer in certain areas and sectors, lack of other sources of finance	Loans, equity investments, structured finance	Yes, technical assistance
EIB (2014) & EIB (2013)	Unclear, figure aggregates different types of additionality and the definition is different	Ex-ante, 102 projects(2014) and 90 projects(2013)	Better financial conditions and capacity to mobilise other finance	Loans, structured finance, equity investments, guarantees, grants (TA and interest subsidy)	Yes, TA and interest subsidy grants

Study	Financial additionality	Type of evidence and sample size	Why	Main instruments	Use of grants
IADB (2014b)	Yes, 63% of projects: 43% of all corporate projects and 83% of FI projects	Ex-post, 24 projects	Better financial conditions, capacity to mobilise other finance and TA	Loans, some TA	Yes, TA
Coffey Intern-ational (2012)*	Unclear, 60% of grantee respondents indicated projects would have started in 3–5 years and 10% in or 6–10 years (10%). Fund Management team indicates that 11 projects (52%) would not have happened at all, 5 projects (24%) may have started in the 5–10 years and the remaining 5 projects (24%) could have been implemented anyway	Ex-post, 21 projects	Competitive selection, strict selection criteria, support during implementation and local knowledge	Grants, not a leveraging project	Yes
Ashley et al (2014)*	Yes, though based on perception of how useful TA was, not compliant with definition. High in 50% of projects, medium 40% and low 10%	Ex-post, 40 projects	Flexible, good designed and locally tailored TA	TA and knowledge sharing only	Yes, TA
Campos et al (2012)*	No, 25% stated that they would have pursued the activity anyway, 49% confirmed that they would be pursuing the activity in the absence of the matching grant	Ex-post, 7 projects	Donors tend to pick companies with high-growth potential (more likely to get funding), application is too complicated for most firms, short time-frames	Grants	Yes
Norad (2009)	No, most private sector projects would have taken place anyway	Ex-post, case studies in 3 countries	n/a	TA	Yes
ADB (2007)	Yes, but different definition	Ex-post, 40 projects in 3 countries	Helped to improve access to finance, signalling effect	Loans, structured finance, guarantees, equity investments, TA	Yes, TA
Lindahl (2014)	Unclear, 4 projects show additionality, 3 none, 3 mixed, rest unknown	Ex-post, 14 projects	n/a	Guarantees	No

Study	Financial additionality	Type of evidence and sample size	Why	Main instruments	Use of grants
Boocock and Shariff (2005)	Some, 8 projects would not have taken place or would have done so in a more limited way; none in 3 projects	Ex-post, 15 project	Higher in smaller firms seeking small amounts	Guarantees	No
IEG (2013)	Some, 56% would not have taken place, 44% used the program for transactions that they would have executed anyway. Additionality perception was higher among confirming banks (71% and 21% respectively)	Ex-post, survey of over 400 participating banks	When yes: lack of alternative, right pricing. Higher in countries with poor banking system	Guarantees	No
IEG (2008)	Yes, but different definition. 85% of projects show some type of financial additionality: better financial terms (55 %), funds mobilization (46 %) and market risk comfort (30%)	Ex-post, 692 projects	When yes: better financial conditions, capacity to mobilise other finance and TA	Loans, structured finance, equity investments, guarantees, TA grants	Yes, TA
ECA (2014)	Some, 15 of the 30 projects examined there was no convincing analysis to show that a grant was necessary in order for the loan	Ex-post, 30 projects	Grants were marginal, strong incentives for project to go ahead, similar initiatives proved the grant was unnecessary	Interest rate subsidies, TA	Yes

*Document refers to projects involving direct support to the private sector in the form of grants and therefore does not fully comply with the definition of leveraging. However, it has been used because it contains useful information.

How many evaluations show financial additionality?

There is no uniform definition of financial additionality, which makes it very difficult to assess several of the evaluations. In the introduction, financial additionality was defined as whether the financial contribution was essential to make the project happen. 8 out of the 17 evaluations used a different definition, usually based on whether the investment provided access to finance in better terms, helped to access additional sources of finance, contributed to tackle the risk perceived by other investors, or the subjective perception of whether technical assistance was useful for the business in the case of TA grants.[2]

The value of all these proxies to measure additionality is questionable. In fact, they only make sense when additionality can be proven. For example, an investment in better financial terms than those available on the market will crowd out other actors and provide a competitive advantage to the project unless it can be proven that it is strictly necessary. Many actors also use the catalytic effect or leverage ratio as a proxy for additionality. The problem is that this is not a proof of additionality. As discussed in chapter 4, measuring the amount of finance leveraged by the investment is only useful when it can be proven that other investors would not have joined the project in the absence of public funds.

In some other cases, the way additionality is measured poses some challenges. For example, in BIO (2014) a satisfactory performance in terms of additionality includes projects where the financial contribution was not essential for it to happen. In the case of the EIB reports, different types of additionality are bundled together and it is not possible to differentiate between them.

If we ignore these projects because they do not stick to the definition provided in the introduction, only 9 evaluations remain.[3,4] These evaluations show quite a mixed picture of financial additionality. Two evaluations, IEG (2013) and ECA (2014), found that about half of the projects were additional. Sjö and Ulväng (2008) found that only one third of the projects were additional. IADB (2014b) found that 63% of the projects were additional. In 3 evaluations, Lindahl (2014), Boocock and Shariff (2005) and Coffey International (2012), additionality is unclear because several projects were difficult to measure or the methodology makes it difficult to make a clear call. Campos et al (2012) and Norad (2009), found little or no additionality, although the latter is not very rich in details.

If we focus on those evaluations compliant with the definition and looking at the use of ODA grants, the results are slightly more negative. ECA (2014) found 50% of the projects were additional. Campos et al (2012) and Norad (2009) suggest there is little additionality. IADB (2014b) is difficult to assess as it includes other instruments and it does not break down the information. As discussed above, Coffey International (2012) is difficult to assess.

What can we learn about why or why not projects showed financial additionality?

In general, evaluations do not offer much information about why projects did or did not mobilise additional financial. Nonetheless, they offer a number of plausible explanations which can be broken down into three groups.

Firstly, several of the evaluations point to the design of the project as a key stage in terms of additionality. This is the case in 5 documents,[5] which refer to issues such as pricing, existence of other incentives, the selection process or other aspects closely linked to project design. Choosing the right countries could also have an impact on additionality. IEG (2013), which looks at a great number of projects, indicates that focusing on countries with underdeveloped banking and financial systems was correlated to greater project additionality.

Campos et al (2012) goes a little bit further in exploring the impact of the selection process on additionality. It suggests three explanations to account for the lack of additionality. Firstly, donors tend to focus on high growth companies, which are also more likely to attract other investors. This could be motivated by the risk aversion of project selection procedures that give priority to the economic and financial performance of the investment. Secondly, the application is too complicated for most firms. This excludes more informal or smaller companies which usually find it more difficult to access finance. Thirdly, projects are relatively short term, which limits the impact over the long-term.

Secondly, some of the literature suggests projects targeting SMEs could be linked with higher levels of additionality. Boocock and Shariff (2005) found that additionality was higher when projects involved smaller firms looking for small amounts of finance. The findings of Coffey International (2012) also point to smaller projects and locally tailored support as a driver of success, although one has to be careful when assessing the findings because all projects were in small rural companies and the instrument is not fully compliant with the definition of leveraging.

Finally, Sjö and Ulväng (2008) suggest that additionality was higher the earlier SWEDFUND got involved in the project because it had a greater influence over its shape and features. This explanation complements and offers a potential insight into the link between the design of the project and the existence of financial additionality. It seems reasonable that an earlier involvement in the project would allow donors to influence it to a greater extent, especially in the case of technical assistance. Some of the findings in ECA (2014) seem to support this idea.

Methodological approaches to measure financial additionality

As we have seen there are not many evaluations available on financial additionality. In some ways, this is a surprising finding because additionality is usually measured ex-ante by donors (MDBs, 2011). However, there are a number of challenges with this approach. Firstly, assessments are not usually available or only a summary version of them is released. Access to monitoring reports is also restricted. This can be confirmed by visiting the project database of any DFI and has been highlighted by Heinrich (2013) Kindornay and Reilly-King (2013). Di Bella et al (2013) also point out that "limited public information exists on the specific criteria used by development cooperation actors to assess the additionality of engagements with the private sector". Some of the documents consulted in this evaluation suggest that sometimes donors use subjective criteria and proxy indicators to measure additionality. This view is confirmed by IADB (2014b) for example, which indicates that: "the assessment of Additionality was mostly based on qualitative descriptions, often lacking objective supporting evidence". Coordinated efforts are being made to improve the quality of the ex-ante assessment as illustrated by DCED (2014).

Additionality is not a critical feature in the ex-ante evaluation of projects supported by DFIs, meaning that it is not a necessary condition for the project to go ahead.[6] This approach might make sense in projects which do not involve the use of grants (e.g. many of those implemented by DFIs), but it no longer works when ODA grants are involved. For example, DFIs might prefer to prioritise development impact over additionality and also have a mandate to be self-sustainable. However, the picture changes when grants are involved. Without financial additionality projects, grants become an unnecessary subsidy and displace other investors.

As we have seen the number of ex-post evaluations is limited and, as seen above, the methodologies used in them are not consolidated or harmonised. The previous section has already shown how different donors apply different definitions and proxies. Evaluations also use different approaches. The most common one is the use of ex-post surveys asking participants whether donor participation was necessary to make the project happen. In itself, this is a subjective evaluation. Others (Boocock and Shariff, 2005) have tried to go one step further by analysing different economic and performance variables. The robustness of different approaches has not been measured.

There are also doubts about whether measuring financial additionality is as simple as saying whether the investment would have happened or not. Although this might be less of a challenge when using surveys (though there are other challenges), it can be difficult to deal with using econometric approaches (e.g. Boocock and Shariff, 2005). Finally, Campos et al (2012) describe the existence of a "publication bias" among donors, which leads to a predominant release of information about successful projects.

The bottom line is that additionality is difficult to measure because it is very difficult to assess whether a project would or would not have taken place under commercial market conditions (Nuñez Ferrer, 2012). However, this does not make additionality any less important when leveraging private finance with ODA. In any case, the difficulties in measuring financial additionality should boost donor efforts to find common and workable approaches to measure it.

3 REVIEW OF EVIDENCE ON DEVELOPMENT ADDITIONALITY

This chapter reviews the evidence available on development additionality, discusses the methodology used to assess it and identifies existing data and research gaps. The definition of development additionality can be found in the introduction.

Table 5 shows the documents on development additionality that were reviewed in this report and summarises their main findings and features. It contains information for a total of 13 evaluations, although two of them have been aggregated due to their similarities.

Table 5: Literature review on development additionality

Study	Development additionality	Type of evidence and sample size	Why	Instruments	Use of grants
Sjö and Ulväng (2008)	Unclear: high in 12, medium in 4 and low in 13 of the investments. Could not evaluate 18 investments	Ex-post, 24 projects and review of number of companies	Timing of involvement, the earlier the better	N/A	No
IADB (2004)	Unclear, also evidence of demonstration effect	Ex-post, 55 projects	66% of co-lenders: improved the social and environmental features of the projects. 42% of sponsors: approached the Bank for the sake of "image" or "reputation." 50% sponsors: oversight of environmental, labour, and social aspects is positive. But 76% of the sponsors: see social and environmental requirements as a major obstacle to project preparation and execution	Loans	No
EBRD (2014)	Yes	Ex-post, additionality findings refer to 1 project	Helped to improve the relevant legislation and contractual practices applicable to the sector	Loans	No
IADB (2014a)	Some: 44% of projects, but not all is developmental	Ex-post	Environmental safeguards (11% of the projects). Also improvement of the regulatory framework in a number of projects	Guarantees	No

*Document refers to projects involving direct support to the private sector in the form of grants and therefore does not fully comply with the definition of leveraging. It has been used because it contains useful information.

Study	Development additionality	Type of evidence and sample size	Why	Instruments	Use of grants
EIB (2014) & EIB (2013)	Unclear, figure aggregates different types of additionality and the definition is different	Ex-ante, 102 projects (2014) and 90 projects(2013)	Better standards	Loans, structured finance, equity investments, guarantees, grants (TA and interest subsidy)	Yes, TA and interest subsidy grants
IADB (2014b)	No	Ex-post projects	Evaluation could not substantiate any significant value added, this suggests uncertainty as to the incremental development results had the IIC not provided funding to those clients	Loans, some TA	Yes, TA
Coffey International (2012)*	Evaluation measures results, but not added value	Ex-post, 21 projects	n/a	Grants, not leveraging projects	Yes
Ashley et al (2014)*	Evaluation measures results, but not added value	Ex-post, 40 projects	n/a	TA and knowledge sharing only	Yes, TA
Norad (2009)	Yes	Ex-post, case studies in 3 countries	Directed investment to countries or regions where companies would not necessarily have invested due to a lack of awareness of the potential, or contacts to facilitate implementation	TA	Yes
ADB (2007)	No	Ex-post, 40 projects in 3 countries	Generally ADB is not involved at the very early phase of the project cycle to identify and design transactions that maximize development impacts	Loans, structured finance, guarantees, equity investments, TA	Yes, TA
IEG (2013)	No, but not main focus	Ex-post, survey of over 400 participating banks	Instrument is not able to address underlying weaknesses. Too small to have an overall impact on a country's financial sector.	Guarantees	No
IEG (2008)	Some, operational additionality in 30% of projects, institutional additionality in 35%. Figures overlap	Ex-post, 692 projects	Good advice, honest broker, contributed to legal reform. Sometimes it failed at the same tasks	Loans, structured finance, equity investments, guarantees, TA grants	Yes, TA

How many evaluations show development additionality?

Two out the 13 evaluations reviewed (namely, Coffey International (2012) and Ashley et al (2014)*) measure results rather than added value and do not offer a significant insight into the problem. Another two documents, EIB (2013, 2014), provide aggregated figures.

Three evaluations show no evidence of additionality, ADB (2007), IADM (2014b) and IEG (2013), although the later did not have its main focus on development additionality. EBRD (2014) and Norad (2009) affirm the existence of development additionality in the projects assessed.

The remaining documents are more difficult to read. Sjö and Ulväng (2008) found Swedfund helped to improve the design of the investments in 16 projects (12 high impact and 4 medium), a low impact in another 13 and could not evaluate 18 projects. IADB (2004) found that 66% of the co-lenders involved in the project saw an improvement in social and environmental standards, although it also indicates that 76% of the beneficiaries see standards as an obstacle for the projects. IADB (2014a) found evidence of non-financial additionality in 44% of the projects although not all of it can be considered as development additionality. Better safeguards were reported in 11% of the projects as well as some unquantified improvements in the regulatory framework in a number of projects. Finally, EIG (2008) found some form of operational additionality in 30% of the projects and institutional additionality in 35%of them. Both figures overlap so it is not possible to ascertain the actual number of projects which showed some form of development additionality.

There are only three evaluations exclusively looking at the use of grants: Coffey International (2012), Ashley et al (2014), Norad (2009). Another four evaluations include some form of grants, but they represent a minority of the projects involved and the information is not broken down by instrument.

What can we learn about why or why not projects showed development additionality?

The number of evaluations available and their results make it difficult to draw some clear lessons. Nonetheless, it is possible to outline some potentially interesting trends.

Firstly, it seems donors are able to influence private sector standards through their project requirements. This should have a positive impact on their development outcomes. However, a number of reports have pointed out important challenges when it comes to actually implementing and enforcing those standards (see discussion in Griffiths et al, 2014). Also, improvements in standards seem to be a 'low hanging fruit'.

Secondly, there is limited evidence of actual impacts beyond improvements in the use of standards. Two evaluations, EBRD (2014) and IEG (2008) point out the impact of donors on legislative frameworks, but they refer to a very small number of projects and offer very little background information. Norad (2009) also highlights the added value of donors in finding investment opportunities in developing countries and helping to build the necessary networks of contacts. Nonetheless, it does not offer a comparative assessment of donors' advantages compared to other actors.

Thirdly, donor involvement at an early stage is important in order to influence the design and outcomes of projects. Both ADB (2007) and Sjö and Ulväng (2008) offer some evidence in this regard. This point has already been discussed in chapter 2.

Methodological approaches to measure development additionality

There are important methodological gaps and weakness that make the assessment and comparison of evaluations looking at development additionality very difficult.

Evaluations of additionality seem to remain focused on a few aspects which also seem to be the easiest to measure. We have seen above how most evaluations have looked into whether the project helped to improve private sector standards, but there is little evidence on other forms of development additionality such as improvements to the design of the projects (design additionality) or operational additionality. This can be seen as a sign of an underlying obstacle. As recognised by CAO (2012) in the case of the IFC, there seems to be no instruments to measure environmental and social additionality aspects beyond a few specific and well defined issues.

Another significant weakness in the documents consulted is the lack of comparative baseline scenarios which essentially renders impossible the objective measurement of development additionality beyond improvements in the design of the project. This is a basic requirement when trying to measure complex changes such as legislative reforms, where there is likely to be many factors involved. This seems a common problem not only in the field of development, but also in climate finance, where more research efforts have been made (Purdon and Lokina 2014). This is often a very complex and expensive task, though some methodological approaches propose it as the default option (VCS, 2012).

4 AREAS WHERE ADDITIONALITY HAS A DIRECT AND RELEVANT IMPACT

This chapter examines the relationship between the concept of additionality and other key concepts in the debate about the use of aid to leverage private sector investments. It focuses on two issues. Firstly, it looks at what additionality means when donors talk about leverage ratios. Secondly, it discusses how additionality relates to existing development effectiveness principles committed to by donors, developing countries and other development actors.

Mobilising additional finance: leverage ratios

A leverage ratio can be defined as the result of dividing the total amount of public finance, including finance coming from other public investors, between the total amount of finance provided to the final recipients (ECA, 2012). This is the definition adopted by the European Court of Auditors to assess the amount of private finance that can be leveraged. However, some DFIs use different definitions.

It is common for DFIs to include other sources of public finance in the total figure and therefore claim that they have mobilised it. For example, many DFIs measure the leverage ratio as the coefficient between the amount of finance it provides and total investment. When other DFIs are involved in the same project, this results in higher leverage ratios and double counting – imagine a project where three DFIs take part and they all use the same methodology. A similar problem occurs when other sources of public finance are involved, for example public finance from the recipient government. For more information on the definition of leverage ratios see Griffiths et al (2014).

The concepts of additionality and leverage ratios are often associated in the existing literature. More precisely, as discussed in chapter 2, leverage ratios are often used as a proxy to measure financial additionality. The standard rationale is that the more money donors can leverage the greater the likelihood the investment will be additional. In other words: if the investment raises a lot of money it is very likely they have helped to achieve it. However, there are a number of problems with this rationale.

Leverage ratios only make sense as long as additionality (at least financial) can be demonstrated so they should never be used as a proxy. In the introduction, it has already been argued that if donors cannot demonstrate their contribution is instrumental to make the project happen, ODA is potentially being wasted as it will be displacing (crowding out) other sources of finance and disrupting the market by providing a competitive advantage to a certain actor (e.g. cheaper finance).

Development additionality should also be brought into the equation when estimating leverage ratios. It is very difficult to imagine a project that cannot be improved in order to increase the developmental impact and where ODA funds can only have financial value (i.e. to make it happen). As far as ODA is involved, donors should be able to demonstrate how the use of aid funds contributes to make the project better from a development point of view.

A high leverage ratio means that the ODA is heavily diluted, and therefore more unlikely to be critical or influence the project. Independently of the definition applied, it is not the same to say that donors have provided 1% (high leverage ratio) of the total project finance or 30% of it (low leverage ratio). In general, one could expect that the smaller the contribution of donors, the more likely the project could go ahead without their contribution in a full or a revised format. The same rationale applies to the ability of donors to significantly influence the design of the project so that it delivers better development results. Demonstrating financial and development additionality becomes especially important for donors claiming large leverage ratios.

Additionality and development effectiveness principles

Over the last 10 years, donors, partner countries and other development actors have developed and agreed to implement a number of development effectiveness principles. In Paris (2005), Accra (2008), Busan (2011) and Mexico (2014), the development community met to take stock of what was working and define new ways to make aid more effective.

Insofar as ODA is involved, these principles should apply. However, a number of research efforts have identified limitations in the application of these principles to leveraging projects involving the use of ODA.[7] Before analysing this problem in more detail, it is important to understand where the problem might be coming from. In general, we can talk about conflicts at two levels:

- **Institutional level:** Most donors (e.g. aid agencies) have the delivery of aid as their main mandate and have therefore developed systems to implement and track development effectiveness principles. However, most of the ODA funds used to leverage private investments are being channelled by development finance institutions, which tend to have broader mandates (including the need to be financially sustainable) and consequently do not put as much emphasis on these principles

- **Implementation level:** Businesses tend to disclose as little information as possible about their activities, systems and plans to maintain their competitive advantage. We could say that the private sector has different expectations when it comes to issues such as transparency, public scrutiny, etc. than aid donors. This is a particularly sensitive issue when donors deal with financial intermediaries, such as banks of investment funds[8]

The sections below discuss in greater detail some of the challenges that using aid to leverage private investments poses for the implementation of the Busan Partnership for Effective Development Co-operation (2011), and how additionality fits into the equation. This analysis suggests that additionality is essential to demonstrate some of these principles are met and that the others are valuable indicators of an aid projects' development additionality.

Ownership of development priorities by developing counties

"Partnerships for development can only succeed if they are led by developing countries, implementing approaches that are tailored to country-specific situations and needs."

Development actors have agreed – based on evidence and research – that ODA projects are generally more efficient and impactful when they respect and support national development plans. There is no reason why leveraging projects should not equally respect and be aligned with the priorities and needs identified in those strategies.

In fact, ownership is as area where donors can add some real added value and experience to leveraging projects compared to other development actors which tend to be less involved in country planning, coordination and dialogue mechanisms. It would make sense to use the concept of ownership when it comes to evaluating the development additionality of leveraging projects both ex-ante and ex-post. Ownership could thus be seen as an indicator of development additionality.

Focus on results

"Our investments and efforts must have a lasting impact on eradicating poverty and reducing inequality, on sustainable development, and on enhancing developing countries' capacities, aligned with the priorities and policies set out by developing countries themselves."

As argued earlier in chapter 4, additionality is essential to demonstrate results in leveraging projects. Both demonstrating that the ODA contribution is necessary to mobilise other sources of finance and that the project design is improved are the starting point for any evaluation of development results.

Transparency and accountability to each other

"Mutual accountability and accountability to the intended beneficiaries of our co - operation, as well as to our respective citizens, organisations, constituents and shareholders, is critical to delivering results."

As outlined above, additionality is key to assessing development results. Objective and comparable data is one of the pillars of accountability. However, this literature review has shown that additionality is not currently being measured consistently and appropriately. In fact we seem to know very little in general and about too few projects.

Transparency is another key development effectiveness principle and an enabling factor for mutual accountability. This is not only about the challenges of using financial intermediaries that have been mentioned above and the poor performance of some donors and institutions.[9]

The literature review demonstrated that there is a significant lack of data about leveraging mechanisms and their additionality. It is essential that donors and other actors involved make a proactive effort to disclose more information about their projects, including unsuccessful ones, as well as the methodologies they use to estimate the leveraging effect. Further building this evidence base as well as being transparent about project design, partners and implements is fundamental to fulfilling the promise to be accountable to beneficiaries in developing countries and other stakeholders.

Inclusive partnerships for development

"Openness, trust, and mutual respect and learning lie at the core of effective partnerships in support of development goals, recognising the different and complementary roles of all actors."

Although it does not have a strong relationship with additionality, this principle captures the idea of involving all development actors in development processes, policy and projects. Practically speaking in this context in particular as public money is being used, ensuring an open, inclusive and robust process seems a vital component of ensuring development additionality. A multi-stakeholder dialogue can also help develop and strengthen a shared and common definition and indicators to better assess the development and financial additionality of leveraging ODA.

5 CONCLUSIONS

The first and most important conclusion of this report is that there is currently relatively little evidence about the additionality of leveraging projects. This applies to both financial and development additionality. This report has identified two major weaknesses in this regard:

- Not enough evaluations: this report has only identified a total of 19 evaluations and documents on the use of ODA to leverage private sector investments or comparable instruments and institutions

- Lack of a common and robust methodology: different actors use different methodologies and approaches to measure additionality. Moreover, the documents are often not very detailed and fail to identify the reasons behind different levels of performance

Overcoming these obstacles requires coordinated efforts in a number of areas. It is not only about conducting more research, but about donors making more information available without any sort of publication bias and starting a multi-stakeholder dialogue to develop a common and robust methodology to measure additionality.

Although evidence is weak, existing literature points to a number of factors that might have a significant impact over the financial and development additionality of leveraging projects. Additional research would be necessary to confirm whether these drivers do actually play a role.

Drivers of financial additionality:

- **Project design:** especially financial aspects, has a significant influence over its additionality. Bias in the selection of companies and complex application mechanisms could also influence additionality

- **Choice of countries:** can have an impact on additionality. Generally higher in countries with underdeveloped financial systems

- **Timing:** the earlier the institutions got involved in the project design the greater the chances to influence it

- **Focus on SMEs:** there is some evidence that projects targeting SMEs could be linked with higher levels of additionality

Evidence about the drivers of development additionality is mixed and many documents do not offer sufficient insight into the question. The few cases that are detailed enough suggest there are a number of mechanism through which projects may achieve development additionality:

- **Standards:** projects have to adopt the standards of public financiers. However, there is weak evidence about their actual implementation

- **Timing:** the earlier the institutions got involved in the project design the greater the chances to influence it

- **Discovery:** there is limited evidence of donors helping to identify new opportunities and markets for investors and using their contact networks to attract them

- **Spill over effects:** there are examples of legislative reforms carried out as a result of projects, but evidence is not very strong

This report also looks into two other questions where additionality has a direct and significant impact. It first looks at the relationship between additionality and leverage ratios and concludes that leverage ratios only make sense as long as additionality can be demonstrated. This conclusion also invalidates the use of leverage ratios as a proxy to measure financial additionality.

Secondly, this report examines whether and how additionality has an impact on the implementation of the development effectiveness principles. The report builds on other research papers to suggest that the use of ODA to leverage private investments can be difficult to align with aid effectiveness principles and identifies the main causes for it. This underscores the need for more dialogue in the development effectiveness processes to address these challenges.

More importantly, additionality should play an important role in assessing whether leveraging projects supported with ODA funds fulfil the development effectiveness principles. Chapter 4 argues that additionality should be seen as either a performance indicator or a necessary condition for compliance.

As this is likely to be an area of continuing interest and increasing investment in development, the relative lack of evidence found by this review suggests that there is much more to be done to develop a sound and comprehensive evidence base. Nonetheless, this paper and the evidence so far also suggest some useful and potentially fruitful areas for further exploration. Developing and translating further evidence and research into clearer shared definitions, best practice guidelines and indicators to guide projects and interventions should be a necessary and urgent next step.

METHODOLOGY

The starting point of the literature review that underpins this report has been a search on academic databases, search engines and donor websites for results containing the work "additionality", "development", "private sector", "leveraging", "private finance" and other variants in different combinations. This yielded over a hundred reports and papers.

The documents were subsequently screened according to the following questions:

- Does it include information on either financial or development additionality, even if the word additionality is not used?
- Does the information refer to projects in developing countries?
- Does it involve the use of ODA? If not, does it relate to instruments, facilities or institutions which can be susceptible to engage in leverage operations using ODA?
- Is the data based on specific projects and quantified? As opposed to being a theoretical discussion
- Does the information refer to other publication already included in the list?

After applying screening all the documents a total of 19 different references have been used in chapters 2 and 3.

Given the limitations in the information available and the important role of DFIs in the leverage of private finance with ODA, and that it is the largest body of evidence, we have also looked into the additionality of DFIs' operations not including the use of grans. This has been indicated in the tables available in chapters 2 and 3. Given the role of DFIs in selecting and channelling projects, the additionality of their development projects can be used as a proxy for the additionality of blending projects.

ENDNOTES

1 Based on Griffiths et al (2014), Spratt and Ryan-Collins (2012) and IEG (2008).

2 IADB (2004), IADB (2014a), BIO (2014), EIB (2014), EIB (2013), Ashley et al (2014)*, ADB (2007) &IEG (2008).

3 We have included here Coffey International (2012), which uses a slightly different measure based on when the project would have taken place without the investment rather than a strict yes or no answer.

4 As indicated under table 4, 2 out of these 10 evaluations refer to projects which are not fully compliant with our definition of leverage.

5 IEG (2013), ECA (2014), IADB (2014b), Coffey International (2012) and Campos et al (2012).

6 See the IFC's Project evauation templates available at: http://www.ifc.org/wps/wcm/connect/IEG_Ext_Content/IFC_External_Corporate_Site/IEG+Home/EvaluationProcess/Investment+Operations/; and the Inter-American Investment Corporation's Development Impact and Scoring Template avaiallbe at: http://www.iic.org/sites/default/files/pdf/dias_scoring_template_for_fi_projects.pdf

7 For example, when it comes to accountability, transparency and demonstrating results. See Griffiths et al. (2014) and Romero and Van de Poel (2014).

8 Intermediaries are usually reluctant to make public any information about their loans or investments because ODA funds are generally pooled with their own resources and feel that revealing their portfolio would leave them exposed.

9 See footnote vi. For overall donor transparency see the Aid Transparency Index (ATI): http://ati.publishwhatyoufund.org/

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