EXTERNAL VIEW
THE COMPLEMENTARY ROLE OF DEVELOPMENT FINANCE INSTITUTIONS

INTERVIEW WITH THOMAS BREU, DIRECTOR OF THE CENTRE FOR DEVELOPMENT AND ENVIRONMENT (CDE) AT THE UNIVERSITY OF BERN

Investments made by SIFEM – primarily into local investment funds and financial institutions that target SME development – are complementary to other instruments of Switzerland's development cooperation initiatives including the economic and trade measures deployed by SECO. Indeed, SECO essentially finances technical assistance and capacity-building programs geared towards strengthening the private sector, but also public institutions and services (focusing on sound macroeconomic management). This includes reforming the business climate of partner countries, fostering entrepreneurship and the implementation of core labour standards, strengthening the trade competitiveness and export readiness of local SMEs, and supporting a more efficient use of natural resources in urban development, energy supply and private businesses.

OBVIAM: WHAT CONTRIBUTION SHOULD THE PRIVATE SECTOR IN DEVELOPED (E.G. SWITZERLAND) AND DEVELOPING COUNTRIES MAKE TOWARDS THE ATTAINMENT OF THE GLOBAL SUSTAINABLE DEVELOPMENT GOALS (SDGS)?

T. Breu: When it comes to the attainment of the 17 SDGs, the private sector clearly plays a vital role. By and large, foreign direct investments far exceed the current annual global official development assistance figure of USD 135 billion, and therefore provide crucial resources to the financial needs for implementing the SDGs which is estimated cost up to 3-5 trillion US dollars. If made correctly, these investments can strengthen local economies and create both income and jobs. The question is not so much whether there are sufficient investment opportunities in developing countries, but rather how private sector financing can target SDG-relevant priorities to achieve sustainable growth. To further strengthen the positive effects in the target countries beyond the initial investment, it is crucial to ensure that profits of corporations are properly taxed in the respective target countries of investment. In that particular area, the private sector has a clear obligation to meet legitimate public and political expectations.

OBVIAM: HOW DO YOU PERCEIVE THE DIVISION OF LABOUR AND THE COMPLEMENTARITY BETWEEN OFFICIAL DEVELOPMENT COOPERATION (SDC, SECO) AND THE PRIVATE SECTOR?

T. Breu: For the poorest developing countries – especially those situated in conflict areas– experts agree that conventional public development cooperation is indispensable and will remain a crucial factor in the future. It is understandable that private investors are particularly reluctant to be active in these very risky areas. However, in politically stable developing countries, the situation is different and it is important that private sector investments take place. Simultaneous investments by the private sector in addition to relevant official development assistance projects has been shown to have a considerable leverage effect on achieving sustainable economic growth. This strengthens the relevance of having different actors using different instruments in the field of development cooperation initiatives, using innovative ideas such as "blended finance", that is, blending grant funding and private funding to mitigate investment risks and help scaling up private investments in sectors of relevance for the SDGs. Although the benefits of such public-private partnership (PPP) projects are high, it is important to also be aware of the risks involved. PPPs are often rather complex and costly. There is a chance that the public sector will bear a disproportionate amount of the investment risk on its own, which at worst could be equivalent to subsidizing private enterprises. This being said, it is important that the public sector be subsidiary to private investors: the role of the public sector should be to crowd in further investments. While doing so, risks must be shared to create the appropriate level of incentives for everyone.

OBVIAM: WHAT ROLE SHOULD BE PLAYED BY DEVELOPMENT FINANCE INSTITUTIONS SUCH AS SIFEM WHICH SUPPORT THE PRIVATE SECTOR IN THE DEVELOPING COUNTRIES WITH PUBLIC FUNDS?

T. Breu: The role of SIFEM in promoting private sector development is regarded as an important and efficient building block of development cooperation by all relevant development stakeholders including the public, NGOs, the private economy, and the academic community. However, the development role of SIFEM's investments largely depends on the monitoring of clearly defined and measurable development effects. As a matter of principle, such private sector investments must be guided by the needs of the developing country's population and must adhere to strict environmental, social, and governance standards. Such investments should also lead to economic diversification to create new jobs and reduce income disparity. In this respect, fostering better economic and social inclusion should be part of value-add of a development institution such as SIFEM. Having a responsible investment approach is therefore a precondition for contributing to sustainable development for the long term.

OBVIAM: TRADITIONAL DEVELOPMENT COOPERATION PROJECTS, WHICH ARE FINANCED BY GRANTS, ARE COMPLEMENTARY TO THE INVESTMENT APPROACH ADOPTED BY SIFEM, WHICH EXPECTS TO ACHIEVE BOTH A DEVELOPMENT IMPACT AND A FINANCIAL RETURN. WHICH APPROACH MAKES MORE SENSE WHEN THE AIM IS FOR SMES TO BE ABLE TO CREATE JOBS IN DEVELOPING COUNTRIES?

T. Breu: I see no fundamental contradiction between the two development approaches. If they are correctly designed and coordinated, they constitute an ideal combination and are even interdependent. In short, traditional development cooperation projects tend to improve the business environment and encourage sustainable business practices. Improvements in the political and legal framework, increased efficiency of public administration, and strengthening of financial sector regulation and supervision are classic focus areas for development cooperation. Clearly, improved conditions for private economic activity and the establishment of properly functioning markets must be major concerns for all governments. Investment approaches – such as that followed by SIFEM – provide long term and affordable financing to assist the growth of promising local enterprises using a market approach, albeit with a higher risk tolerance. Making investments without expecting financial returns would send the wrong signal to market players and create unnecessary market distortions.

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is Professor and Director of the Centre for Development and Environment (CDE) at the University of Bern and Executive Director of the North-South Graduate School (IGS). He studied geography and economics and has more than 20 years of experience in research and field experience in developing countries with the focus on South East Asia, East Africa, and Central Asia. In this context, he was Chief Technical Adviser to the Mekong River Commission and the Governments of the Riparian States of the Mekong in the area of land and water use planning from 1997 to 2001. He represented Swiss science in the official Swiss delegation to the UN Conference on "Financing for Development" in Addis Ababa in July 2015.