

# Can the US Development Finance Corporation Compete?

**Charles Kenny**

## Abstract

The new US International Development Finance Corporation (USDFC) will be considerably larger than its predecessor, and it will also be more focused on low and lower middle income countries. It will have new tools to deliver but face expanded competition. The major challenge to the DFC is not Chinese investment (which largely funds projects ill-suited to support from the DFC), but other development finance institutions, many of which are deploying increasing quantities of subsidized capital to attract project sponsors. It is not clear that there are sufficient suitable deals in the shrinking set of low and lower-middle income countries to absorb DFI development finance, and the USDFC could lose projects to subsidized finance from elsewhere if this turns out to be the case. Given that, it should be a priority for the United States to agree rules with other donors that prevent development finance institutions from competing on the basis of subsidy. The new DFC needs increased capacity to deliver deals: both the tools provided by the BUILD Act which are being constrained by the administration and the staff and budget to actively build a pipeline of projects. A considerably bolstered administrative budget may involve reducing—potentially to zero—the profitability OPIC traditionally enjoyed.

Center for Global Development  
2055 L Street NW  
Fifth Floor  
Washington DC 20036  
202-416-4000  
[www.cgdev.org](http://www.cgdev.org)

This work is made available under  
the terms of the Creative Commons  
Attribution-NonCommercial 4.0  
license.

## Can the US Development Finance Corporation Compete?

Charles Kenny

Center for Global Development

Thanks to Scott Morris and Erin Collinson for comments.

The Center for Global Development is grateful for contributions from the Bill & Melinda Gates Foundation in support of this work.

Charles Kenny, 2019. "Can the US Development Finance Corporation Compete?" CGD Policy Paper 158. Washington, DC: Center for Global Development. <https://www.cgdev.org/publication/can-us-development-finance-corporation-compete>

**Center for Global Development**  
**2055 L Street NW**  
**Washington, DC 20036**

202.416.4000  
(f) 202.416.4050

**[www.cgdev.org](http://www.cgdev.org)**

The Center for Global Development works to reduce global poverty and improve lives through innovative economic research that drives better policy and practice by the world's top decision makers. Use and dissemination of this Policy Paper is encouraged; however, reproduced copies may not be used for commercial purposes. Further usage is permitted under the terms of the Creative Commons License.

The views expressed in CGD Policy Papers are those of the authors and should not be attributed to the board of directors, funders of the Center for Global Development, or the authors' respective organizations.

## **Contents**

Introduction .....	1
The Challenges of LIC/LMIC Investment.....	2
Is Chinese Investment Competition for the US DFC?.....	6
Competition from Other Development Finance Institutions.....	7
Conclusion.....	11
References.....	16

## Introduction

The new US International Development Finance Corporation (DFC), successor to the Overseas Private Investment Corporation (OPIC), will be a major player in global development finance. The DFC will have a liability limit of \$60 billion, compared to OPIC's current \$29 billion, suggesting, in time, it will be able to mobilize \$31 billion in additional financing for private sector investments in developing countries. This will likely cement the US DFC as the largest Western bilateral development finance institution.

This greater financing power will be targeted at low and lower middle income countries (LICs and LMICs), currently the recipient of about 46 percent of OPIC-backed finance. To quote the BUILD Act, the USDFC's authorizing legislation<sup>1</sup>:

*“The Corporation shall prioritize the provision of support ... in less developed countries with a low-income economy or a lower-middle-income economy. The Corporation shall restrict the provision of support [in] an upper-middle-income economy unless— (A) the President certifies to the appropriate congressional committees that such support furthers the national economic or foreign policy interests of the United States; and (B) such support is likely to be highly developmental or provide developmental benefits to the poorest population of that country.*

This focus on the 78 countries worldwide with a (2018) GNI per capita below \$3,996 is appropriate, given that poorer countries are those where the DFC is likely to be able to make the biggest difference. Low and lower middle income countries face greater barriers in financing projects, and are home to the world's poorest people. Furthermore, low and lower middle income economies are where the US DFC has the scale to matter. USDFC's \$60 billion spending cap is equal to 11 percent of low income countries' combined GNI, 1.0 percent of lower middle income GNI and 0.3 percent of upper middle income GNI.

The US DFC has new tools to deliver impact. This includes equity authority, local currency loans, first loss guarantees, and small grants.<sup>2</sup> In addition, the OPIC requirement to back US companies has been softened to a “preference” for U.S. investors. This could have a significant effect –given the vast majority of firms investing in LICs and LMICs are not American.

But investing in lower-income economies has proven complex for all DFIs, whatever their range of product offerings. In 2010, the World Bank's private sector arm the International Finance Corporation (IFC) committed that 50% of projects would be in IDA countries, a

---

<sup>1</sup> Corker (2018)

<sup>2</sup> Some of the advantage of being able to take on equity will be diluted if it is scored 1:1 against the budget. (Moss & Collinson, 2019)

subset of largely low and lower middle income economies.<sup>3</sup> Between 2013–2016, the IFC’s share of investment in IDA countries was just 25 percent.<sup>4</sup>

Country characteristics in poorer economies are not favorable to the DFI operating model, making it hard to find investment opportunities. Especially given the growing size of DFIs overall, that may lead to greater competition between them for the deals that exist. With the increasing availability of grant finance to the IFC and European DFIs, which institution wins that competition may be decided on the basis of the size of subsidy they offer to project sponsors. As well as misdirecting global aid resources, such competitions would put the US DFC at a significant disadvantage.

This paper discusses the challenges for DFIs of investing in LICs and LMICs, as well as potential competition to the USDFC from China and other DFIs. It closes with policy responses to respond to the most significant threat: that of aid-financed subsidies deployed by other DFIs.

## **The Challenges of LIC/LMIC Investment**

Development finance institutions including OPIC (directly) invest in projects backed by firms that can pass their financial, reputational, environmental and social safeguard screening and that have the minimum scale for size of the investments DFIs tend to make (an average of about \$33 million for OPIC for example).<sup>5</sup> This significantly constrains the number of project sponsors –and projects—likely to be available for DFIs because these requirements simply exclude the bulk of private sector investments in poorer developing countries.

There are very few large, formal, productive firms in those countries.<sup>6</sup> A considerable part of of private sector output in LICs and LMICs comes from the informal sector. Medina et al. estimate<sup>7</sup> the informal economy accounts for more than 50 percent of GDP in Nigeria and Tanzania and above 40 percent in another ten Sub-Saharan African countries, for example.<sup>8</sup> At the other end of the scale, in all of Sub Saharan Africa outside of South Africa there are only approximately 183 firms with revenues greater than \$500 million and about 87 with revenues greater than \$1 billion (in the US there are about 7,000 firms with revenues over \$500 million and 3,908 with revenues over \$1 billion).<sup>9</sup> An ‘Enterprise Map’ by John

---

<sup>3</sup> World Bank, 2010

<sup>4</sup> Kenny, Kalow, & Ramachandran, 2018 (Of course it may be that they did many small projects in IDA countries –perhaps more damning is that the trend of the proportion of new investments was five percent lower than before IFC committed to focus on IDA countries)

<sup>5</sup> Leo & Moss, 2016

<sup>6</sup> See Sandefur (2010) and Poschke, 2018; Van Biesebroeck, 2005.

<sup>7</sup> Medina et al., 2017

<sup>8</sup> 41 out of 48 Sub Saharan African economies are low or lower middle income and Sub Saharan Africa accounts for more than half of all LICs and LMCs. (World Bank, 2019)

<sup>9</sup> Again, only four stock markets in Sub Saharan Africa excluding South Africa had a market capitalization of above \$6 billion in 2017 and only one (Nigeria’s) is larger than \$30 billion. (McKinsey & Company, 2016; McKinsey & Company, 2018; Price Waterhouse Coopers, 2019)

Sutton suggests Ethiopia only has 43 firms which employ more than 500 employees.<sup>10</sup> In Tanzania, the Enterprise Survey sample frame suggests there were just 244 firms country-wide with more than 100 employees.<sup>11</sup> For comparison, the US has 19,000 firms with over 500 employees and 107,000 with over 100 employees.<sup>12</sup>

There are even fewer internationally competitive firms. Sutton suggests that just 13 firms account for three quarters of Mozambique's exports, 22 firms for about one half of Tanzania's, 27 firms for 62 percent of Ghana's exports, and 31 firms for about half of Ethiopia's.

Firms in infrastructure and banking in poorer developing countries tend to be larger and more formalized than in other sectors, and so more suited to DFI operational models. Banking and finance and infrastructure between them account for over two thirds of all commitments to mobilize private finance in low and lower middle income countries by Multilateral Development Banks and DFIs between 2013-2017.<sup>13</sup> But these sectors account for only a small proportion of total output. In India, for example, finance, transport, communications and utilities collectively only account for about 15 percent of gross value added.<sup>14</sup>

Finance and infrastructure sectors also tend to be highly concentrated, leaving few potential project sponsors. In Ethiopia, two banks controlled 88 percent of total banking assets in 2014 –both were state owned. Only eight banks had assets over \$500 million.<sup>15</sup> In Tanzania, the five largest banks control about 60 percent of assets and (again) only eight banks had assets of more than \$500 million.<sup>16</sup> The number of major infrastructure providers active in developing countries is also limited not least by the natural monopoly and centralized status of much infrastructure. Many of those providers are multinationals.<sup>17</sup>

And across sectors, the small potential sponsor pool is constrained by considerably more than the financial issues that might be addressed by DFIs. Larger firms in low and lower middle income countries report that most of their investments are financed internally (76 percent) and that only 29 percent use banks to finance investments (this according to

---

<sup>10</sup> See here and subs: (Sutton & Kellow, 2010). The most recent enterprise survey sample frame includes 1,979 firms with over 100 employees, suggesting a dramatic drop-off in larger firm distribution. (World Bank, 2016)

<sup>11</sup> World Bank, 2015

<sup>12</sup> US Small Business Administration, 2019

<sup>13</sup> See Attridge and Engen (2019). Finance and infrastructure accounted for more than 70 percent of all OPIC investments 2008-2014 (Leo & Moss, 2016)

<sup>14</sup> Real estate and construction would add another 23.4 percent (Ministry of Statistics and Programme Implementation, 2017)

<sup>15</sup> Assuming 20 Birr = \$1 (Pound Sterling Live, 2014; data from Belda, 2016)

<sup>16</sup> Assuming 2100 TZS (Online Currency Converter, 2015) data from (International Monetary Fund. African Dept., 2016) (Table A1)

<sup>17</sup> A dated estimate from the early 2000s suggests that less than 30 percent of private investment in infrastructure involving private participation came from local firms investing in projects in their own country, suggesting the dominant role for (a relatively few) international players.

Enterprise Survey data reported in Table One). At the same time, they do not list access to finance as their biggest constraint, and access to finance is less of a barrier for large firms than it is for small ones.<sup>18</sup> While 24 percent of large firms do suggest financing is an issue, political instability and access to electricity rank more often as biggest constraints and informal sector competition, corruption and taxes are listed nearly as often (Figure One).<sup>19</sup> Other barriers include weak governance, higher import tariffs, weak logistics systems, and low quality infrastructure (Table Two).

In addition, most low and lower middle income countries are very small markets. Five countries accounted for two thirds of total GDP of low and lower middle income countries as a whole in 2017 –Pakistan, The Philippines, Nigeria, Indonesia and India.<sup>20</sup> Of the 78 LICs and LMICs for which the World Bank has 2017 data, only 23 have an output larger than the United States’ 100<sup>th</sup> largest metro area, Chattanooga. Only two (India and Indonesia) have an economy larger than the tenth largest US metro area, Atlanta-Sandy Springs-Roswell. Given the fixed costs of setting up in a new country in terms of market knowledge, licensing and registration, small countries will be at a disadvantage in terms of attracting international investment.<sup>21</sup>

FDI in particular is limited by weak business environments and small markets. Total net FDI into LICs and LMICs in 2017 was \$143 billion –a total of less than \$2 billion per economy. Excluding India, Indonesia, Vietnam, the Philippines and Egypt, the total falls to \$50 billion. Only 24 of 79 LICs and LMICs say net FDI of more than \$1 billion and the median net flow to LICs and LMICs was \$375 million.<sup>22</sup>

The broad range of challenges faced by both foreign and local businesses in LICs and LMICs beyond finance will be why, to quote the mid-term review of IFC’s IDA Private Sector Window, “deal origination in PSW-eligible markets does not come easy.” Investment opportunities in infrastructure, for example, have remained depressed in the last few years, despite the ramp-up in MDB and DFI efforts to support private infrastructure finance (Figure Two). investment in infrastructure projects involving the private sector in low and lower middle income countries has not regained its peak of around \$70 billion in 2010, falling back to \$43 billion in 2017, spread across (only) 138 projects.

And it is worth noting that international public finance is already heavily engaged in providing support to suitable infrastructure deals in poorer developing countries, with little

---

<sup>18</sup> Page and Soderbom (2015)

<sup>19</sup> In Ghana a decade ago, credit access was listed as a major problem by nearly 70% of microenterprises and only 20% of large firms. There is evidence that lack of credit is a significant constraint to small firms in that those firms complaining of little credit see slower growth. Large firms were considerably more likely to complain about interest rates, implying credit is available but (in the eyes of the borrower) expensive (Sandefur, 2010). Note that international guarantee products should be able to provide some insurance against the first-ranked problem of political instability.

<sup>20</sup> Authors calculation from the World Bank (2016) accessed 6/27/2016

<sup>21</sup> Sources: World Bank’s World Development Indicators (2019) and BEA (2017)

<sup>22</sup> Author’s calculation from WDI (World Bank, 2019)

scope for further expansion unless the pipeline of new projects expands again. In 2016, looking at IDA-country deals with financing information in the World Bank's PPI database, 61 percent of finance was provided by multilateral and bilateral institutions and public financing institutions in the countries home to the investment.<sup>23</sup>

Adding to the evidence that low and lower middle Income countries present few opportunities for large investments that can be supported by institutions such as the US DFC, Attridge and Engen estimate that \$1 of public investment in the private sector as a whole mobilizes just \$0.37 of private investment in LICs, and \$1.06 in LMICs.<sup>24</sup> That public sources fund the majority of project costs suggests the limited appetite of suitable project sponsors to operate in these countries despite considerable donor support for project preparation and technical assistance, and the severe challenges likely to be faced by DFIs including the US DFC in ramping up volumes in these countries.<sup>25</sup>

A final additional challenge of a focus on the poorest countries going forward is that they are (thankfully) getting richer. A number of large countries will soon graduate into upper middle income status. Table Three projects the size of the LIC/LMIC economy grouping over the next few years assuming countries grow at three percent per capita and five percent in terms of output (suggesting two percent population growth): it considerably shrinks in 2020-2021 as countries including Indonesia and the Philippines exit LMIC status. India will increasingly dominate the income group. Excluding India, the size of the market may drop from \$4.3 trillion to \$2.8 trillion around 2020. By 2021, the graduates to upper middle income status (compared to 2017) are predicted to be Angola, El Salvador, Georgia, Indonesia, Kosovo, Mongolia, the Philippines, Sri Lanka and the West Bank and Gaza. These countries were responsible for 15 percent of the combined investments in LICs and LMICs of OPIC, the German, French, UK DFIs and IFC between 2012-2016.<sup>26</sup>

---

<sup>23</sup> Marginal, Not Transformational Development Finance Institutions and the Sustainable Development Goals CGD Policy Paper Forthcoming (Kenny, 2019).

<sup>24</sup> Attridge & Engen, 2019

<sup>25</sup> Suggesting a limited pool of potential investees, the largest DFI, the IFC, is reliant on repeat clients for more than half of its commitment volumes, although this proportion is somewhat lower in IDA countries. Across IFC investments, approximately 48 percent involve repeat clients. The proportion is 40 percent in infrastructure but rises as high as 65 percent in financial markets. (Calculated from Independent Evaluation Group, 2017). The US DFC will also inherit a portfolio that is reasonably concentrated. Between 2010 and 2014, OPIC's ten largest clients accounted for roughly 40 of total commitments worldwide –primarily major US banks on-lending local banks for SME finance projects and power companies involved in energy projects (Leo & Moss, 2016). See Kenny (2019) on the significant donor efforts to increase deal flow and their limited success in developing a pipeline of deals. The challenge of investing in LICs in particular is demonstrated by the three largest LIC recipients of commitments from MDBs and DFIs to mobilize private investment between 2013 and 2017. The top three (Kenya, Myanmar and Bangladesh) were all reclassified as LMICs during that period (Attridge & Engen 2019).

<sup>26</sup> Author's calculation from (Kenny, Kalow, Leo, & Ramachandran, 2018)

## Is Chinese Investment Competition for the US DFC?

Poor countries need more foreign investment. While there are exceptions, that China is supplying some of it is a broad positive. That China is providing investment in ways that are unlikely to significantly compete with the US DFC (because of the size and sectors of investment) is even better for the new institution.

Looking at Africa and FDI in particular, China only accounted for around 5%<sup>27</sup> of global FDI into Africa in 2015. China's total FDI stock on the continent in 2014 was still less than half that of the US, although growing far more rapidly.<sup>28</sup> Chinese FDI was focused in mining and construction (54%) and manufacturing (13%).<sup>29</sup> This suggests China has not had a significant role in investments in financial institutions in LICs and LMICs to date, but the strong presence in construction is clearly linked to a growing role in building new infrastructure, which might be thought to compete with potential DFI-backed projects.

Many construction projects involve somewhat concessional credit from China Exim Bank, financing infrastructure projects tendered to Chinese companies, with costs typically 20-30% lower than those of competitors from other countries. Through activities including the Belt and Road initiative and institutions including the China Export-Import Bank and the China Development Bank, China has considerably increased financial support in particular to infrastructure in developing countries. China's non-concessional development investment lending between 2000 and 2014 is estimated at \$276 billion.<sup>30</sup> Much of the lending is commodity backed and usually above LIBOR according to Brautigam et al.<sup>31</sup>

It might be argued that Chinese lending for large public construction projects is constraining fiscal space for private projects, especially in the 50 largest recipients of Chinese debt finance where debt owed to China averages 15 percent of GDP, But as PPPs are frequently used to remove investment costs from the public balance sheet, the reverse may also apply.<sup>32</sup>

Looking at infrastructure in particular, over the 2012-16 period, Deloitte estimates African governments were responsible for about \$30 billion of average annual infrastructure finance in the region, donors and MDBs for \$23 billion, China for \$12 billion, Arab countries for \$4 billion and the private sector for \$6 billion.<sup>33</sup> China is only a part of the 'competition' against private sector infrastructure provision in the region. While it may have financed some

---

<sup>27</sup> Brautigam et al., 2017

<sup>28</sup> Sun, Jayaram, & Kassiri, 2017

<sup>29</sup> Brautigam et al., 2017

<sup>30</sup> Ingram and Mosbacher, Jr., 2018

<sup>31</sup> Brautigam et al., 2017

<sup>32</sup> Horn, Reinhart and Trebesch (2019). Deloitte's (2018) analysis of large construction projects in Africa (482 projects valued at US\$50m or above in 2018) suggests that a third are constructed by Chinese firms, private domestic firms build another one quarter. The projects are predominantly owned by governments (75 percent), and another 9 percent by private domestic firms. And while China has provided finance to 20 percent of these projects, other donors and international public finance including DFIs account for 30 percent, African governments for 25 percent and private domestic sources for 11 percent.

<sup>33</sup> Deloitte, 2018

projects that theoretically could have been supported by Western DFIs using PPI models, PPI saw limited reach in LICs/LMICs prior to Chinese development outreach and has seen stalled growth since then despite significant efforts from MDBs, DFIs and donors. That is reflected in the fact that even Western donors and development banks are using more finance to back public infrastructure projects than projects with private participation.

Outside of infrastructure, Chinese companies are reported to have set up more than 56 economic cooperation zones in more than 20 Belt and Road countries, generating 80,000 jobs over the 2014-16 period.<sup>34</sup> Deborah Brautigam et al.'s survey<sup>35</sup> of Chinese manufacturing in Africa suggests an average \$10 million investment, mostly for local market access. It is not clear how many US firms would have a competitive position in the markets being served by these investments given that Chinese firms have considerably more (recent) experience in serving low-income markets and running low-skilled manufacturing. Furthermore, official financing appears to be a small factor in this investment. A McKinsey survey of Chinese-owned firms in Africa suggest the great majority are privately owned and financed from internal resources, and that only 15 percent of their financing linked to the Chinese government. Financing ranked 10 out of fifteen amongst their concerns regarding constraints to growth.

## **Competition from Other Development Finance Institutions**

The more significant competition faced by the USDFC is from other Western DFIs, all of which are chasing a very small and similar subset of private investment projects in LICs and LMICs that would pass their due diligence and other procedures.

OPIC is already a major player amongst DFIs in low and lower middle income economies. It accounted for about 19 percent of LIC and LMIC investment from the US French, German, UK and Dutch DFIs plus the IFC combined.<sup>36</sup> As the USDFC expands and concentrates in these countries, other DFIs also continue to expand, and also facing mandates to work more in lower-income economies.

Using an extensive list of DFIs, Dan Runde at CSIS estimates that total global DFI and MDB commitments in support of private investments have climbed from around \$12 billion in 2000 to \$87 billion in 2017.<sup>37</sup> This growth is likely to continue, especially in LICs and LMICs. IFC is seeking a capital increase of \$5.5 billion which at current leverage should allow for additional investments worth close to \$15 billion.<sup>38</sup> In addition, it has access to the

---

<sup>34</sup> Zhang, 2019

<sup>35</sup> Brautigam et al. (2017)

<sup>36</sup> Kenny et al. 2018. OPIC's portfolio over the 2012-2016 period (excluding regional investments) has been 46 percent in low and lower-middle income countries, this compares to 44 percent for the IFC. The German, Dutch, French and UK DFIs range between 51 and 100 percent, with an average across these DFIs of 49 percent. Note the CDC was considerably smaller than OPIC (commitments of \$4.5 billion compared to \$18 billion for OPIC 2012-16) and was able to effectively subsidize investments

<sup>37</sup> Total DFI market size from (Runde & Milner, 2019)

<sup>38</sup> Based on a debt to equity ratio of 2.7 from (IFC, 2017)

IDA Private Sector Window which allows for \$2 billion of financing in IDA countries and fragile states in particular. This may be increased renewed under the next IDA replenishment—IDA 19. Between 2021 and 2027, the proposed EU EFSD+ facility, a worldwide blending and guarantee facility will have a ceiling of €60 billion<sup>39</sup>, suggesting a dramatic scale-up. Between 2015 and 2018, CDC received \$1.8 billion<sup>40</sup> in new capital from DFID and capital injections of up to £703 million per annum are planned until 2021.

A back of the envelope calculation suggests an addition of \$60 billion from the European Union’s DFIs and MDBs to the portfolio of investments in LICs and LMICs over the next few years, up from approximately \$27 billion today.<sup>41</sup> Add \$34 billion from the IFC portfolio up from \$25 billion today and \$52 billion from the USDFC up from approximately \$13 billion today. That suggests a total LIC/LMIC portfolio from the IFC, US DFC and European DFIs of \$146 billion up from \$67 billion today—more than a doubling of the portfolio size.

A number of DFIs including the IFC have suggested that they cannot ramp up investment in lower-income economies without the ability to subsidize investments (or at least an acceptance of lower returns).<sup>42</sup> The term ‘subsidy’ is a loose one, given that all DFIs including OPIC provide financing terms that are likely more generous than those project sponsors could find in private markets. But a number of DFIs have an explicit strategy to earn low or negative returns on at least elements of their portfolio, sometimes supported by grant or credit resources dedicated to this purpose. The CDC, which almost exclusively invests in low and lower middle income countries, is meant to have an overall investment hurdle rate of (just) 3.5% per year over ten years. Since 2007, €3.4 billion worth of EU grants have financed over 380 ‘blended finance’ projects.<sup>43</sup>

The 2018 Blended Concessional Finance Report suggests MDBs and Bilateral DFIs made concessional commitments of US \$1.2 billion in 2017, with 72 percent of blended concessional financing was in low and lower-middle income countries. This finance was combined with \$3.9 billion of non-concessional DFI finance and \$0.4 billion in ‘public

---

<sup>39</sup> Gavvas & Timmis, 2019.

<sup>40</sup> (Independent Commission for Aid Impact, 2019)

<sup>41</sup> Assume European DFIs are currently ~60 percent in LICs/LMICs (see Kenny et al. 2018). 60bn Euro of 68 bn Euro in geographic programs are going to be used for EFSD+, 46 bn Euro out of that 68 bn is to be used outside ‘neighborhood’ investments. This suggests a ceiling of about 40bn Euro, I have arbitrarily assumed 75 percent of that goes to low and lower middle income countries and used an exchange rate of 1.1: 1. (European Commission, 2018). Assume 90 percent of a doubled USDFC portfolio is dedicated to low and lower middle income countries. Assume 60 percent of the additional \$15 billion IFC financing goes to LICs/LMICs (with the support of the IDA PSW), assume current portfolio of \$57 billion is 44 percent in IDA. OPIC FY 2017 Portfolio: \$29 billion, European DFI’s 2017 Combined Portfolio: \$45 billion (Ingram & Mosbacher, Jr., 2018; IFC, 2018)

<sup>42</sup> Note also the IFC 2017-19 strategy which reports that deals in fragile states and low income countries face higher transactions costs risks and cost of investment all while projects are smaller, meaning that “the profitability of such operations has been lower than IFC averages, particularly on a risk-adjusted basis.”

<sup>43</sup> The next few years will see a ramp-up with EU blending facilities financed for a total of €2.6 billion by 2020, and the EU EFSD+ facility suggests an even more significant expansion going forward.

contributions' along with an estimated \$4.3-\$5.3 billion of private finance, most generously suggesting 15 percent concessional/grant financing, 36 percent other official financing and 49 percent private financing in ODA-backed private sector deals.<sup>44</sup> This \$5.1 billion of official flows at (considerably below) market rates each year compares to total investments by IFC and four European DFIs of about \$7 billion per year in LICs and LMICs 2012-2016, suggesting a considerable proportion of DFI finance to those countries involves an explicit subsidy component.

Subsidies may sometimes allow DFIs to finance projects that would not happen without them, but subsidies using the standard DFI model of bespoke negotiations with individual, unsolicited project sponsors also increase the risk of supporting low-impact projects and/or crowding out. If there is not a large stock of high-development-impact deals held back only by the requirement of partially subsidized credit, and there is considerable evidence that there is no such stock, there is the considerable risk that more subsidy by DFIs will simply be used to out-compete other DFIs to the same deal, to the benefit of the client firm and with no necessary benefit in terms of development impact. Because DFIs do not have access to information on who else project sponsors are talking to about finance, it will be very difficult for DFIs to know if they are crowding in or crowding out investment with their subsidies.<sup>45</sup> The (unsubsidized) USDFC is a likely victim of such crowding out.

At the same time, the USDFC, funded by the US Treasury, does have an advantage over multilateral development finance institutions that borrow from markets in terms of potential risk appetite. The IFC, for example, needs an AAA rating for access to cheap finance, and is extremely conservative in its approach to risk partially as a result.<sup>46</sup> IFC exposure limits are set for each country based on the size of its economy and its risk rating.<sup>47</sup> Preferential debt exposure to a country is additionally limited by reference to that country's total medium and long term external debt.<sup>48</sup> The Corporation also limits the amount of investment with one client in part based on client credit ratings.<sup>49</sup> These limits may help to account for the fact that, in 2016, less than 3 percent of IFC's investments were in low income countries – although the Corporation has done far better in the past.<sup>50</sup> The IDA Private Sector Window

---

<sup>44</sup> Convergence estimates \$100 billion in blended finance transactions in developing countries 2005-2017, although the volume of new deals annually has fallen off since 2014. Under their definition, blended finance involves either (i) public or philanthropic investors providing concessional capital, bearing risk at below market returns to mobilize private investment, or providing e guarantees or other risk mitigation instruments (ii) grant-funded transaction design or preparation is grant funded or (iii) support from a technical assistance facility. Of that \$100 billion total Convergence suggests about 74 percent of all deals they consider 'blended finance' happen in low or lower middle income countries, and somewhere around 43 percent of all 'blended finance' financing values involve concessional capital.

<sup>45</sup> Carter, 2018

<sup>46</sup> I would argue far too conservative given (i.a.) that net worth exceeds a quarter of its \$94 billion balance sheet, more than 50% of capital is held by AAA/AA sovereigns, and the Corporation enjoys an implicit guarantee from the World Bank with regard to country risk.

<sup>47</sup> International Finance Corporation, 2018

<sup>48</sup> International Finance Corporation, 2017

<sup>49</sup> International Finance Corporation, 2017

<sup>50</sup> Ramachandran & Kenny, 2018

is in part justified as a mechanism to allow the IFC and MIGA to invest more in LICs and LMICs than its exposure limits would allow –because of the small number of potential clients, and the small size and high risk ratings of the economies involved.<sup>51</sup> And the proposed overall capital increase for the IFC is justified in part on the need to balance exposure in FCS and IDA countries with investments in safer markets that have a higher risk-adjusted rate of return.<sup>52</sup>

The USDFC should have greater flexibility in its approach to risk than DFIs that borrow from the market. It will (presumably) follow OPIC in monitoring portfolio risk and reporting according to the Federal Credit Reform Act, and will have a Chief Risk Officer to, develop, implement, and manage a comprehensive process for identifying, assessing, monitoring, and limiting risks to the Corporation, including the overall portfolio diversification of the Corporation.<sup>53</sup> Nonetheless, it will not face market pressure to diversify in a way that limits its ability to invest in particular countries or client firms.<sup>54</sup> In the first decade of the Twentieth Century, a significant majority of OPIC investment was in countries with high commercial risk ratings.<sup>55</sup> This fell in the period 2010-14, but it suggests the potential for the USDFC to bear more risk than (some) other DFIs.

The USDFC may have a particular advantage in large, riskier countries including Angola, and Pakistan and Ukraine, (rated B- by S&P), the DRC (rated CCC+) and Cote d’Ivoire, Tanzania and Tunisia (unrated).<sup>56</sup> It may also be able to take on larger projects in small economies. Additionally there may be an opportunity for the US DFC to co-invest in projects that market-financed DFIs have developed but cannot fully support due to exposure limits. Over the 2012-2016 period, only 2 percent of OPIC’s portfolio was co-financed by any of the CDC, DEG, FMO, Proparco or the IFC compared to 20 percent of CDC deals that were co-financed by OPIC, DEG, FMO, Proparco or the IFC.<sup>57</sup> With relaxed constraints on project sponsor nationality faced by the new USDFC, it may be able to catch up.

The USDFC might also be able to use its comparative risk tolerance to provide capital to companies developing technologies aimed at consumers in lower-income countries on a VC/angel investor model, including software and applications, pharmaceuticals for neglected

---

<sup>51</sup> With regard to the IDA PSW Window, for example, the World Bank Group suggested “limitations on IFC and MIGA capital... are constrained in their ability to significantly ramp up their own activities in the poorest countries.” And needed PSW support to enable that. (IDA Resource Mobilization Department, 2016)

<sup>52</sup> “IFC’s business is migrating to increased complexity and risk, such as through larger and more complex infrastructure projects, increasing exposure to FCS, and focus on ambitious climate targets. Scaling-up will require a stronger capital basis to provide the financial capacity to absorb this higher risk and allow for growth of offsetting business with a more favorable risk-adjusted return.” (World Bank, 2016)

<sup>53</sup> Corker, 2018

<sup>54</sup> OPIC, 2018

<sup>55</sup> Leo and Moss (2016) Inside the Portfolio of the Overseas Private Investment Corporation.

<sup>56</sup> S&P Global Ratings, 2019

<sup>57</sup> Kenny et al., 2018

tropical diseases, pay-as-you-go systems, or small-scale infrastructure models including modular nuclear solutions and off-grid toilets.

## Conclusion

The only countries where DFIs are large enough to have a macro impact in terms of marginal investment are those where their requirements for large, audited, reputable clients cut out a huge part of the private sector. This challenge of working in low and lower middle income countries should be embraced by the US DFC, not least to expand the proportion of the private sector that does meet international investment standards. But the new institution does face obstacles –not least that it is competing in an ever-shrinking market against growing DFIs offering ever-larger subsidies.

It is not at all clear that the model of subsidizing financial terms on deals is an efficient use of ODA, and the response to this threat should not be for the DFC to seek its own blending capacity –especially in an environment where beneficiaries in the presence of greater subsidy are increasingly likely to be multinational firms rather than poor people in poor countries. Instead, the US DFC and its backers in the US Treasury and USAID should work with other Development Finance Institutions to put into place strict rules on the use of subsidies to alter financial terms, perhaps building on the model of negotiations carried out by export credit agencies under the OECD. These principles should include that subsidies should be allocated on the basis of necessity in meeting public policy goals; the norm for subsidy allocations should be competitive approaches or open offers; non-competitive subsidies should only support market making; subsidy levels should be capped; and subsidy levels should be transparent.<sup>58</sup>

But (especially without subsidies), finding good deals with strong development impact in increasingly competitive and very complex markets for DFI-suitable investments will require considerable effort (with high transaction costs and potentially more, smaller deals). As part of the effort, the DFC can more actively explore co-financing options and focus on countries more likely to hit the exposure caps of market-financed DFIs. It might also consider approaches to providing financing to firms under-served by other DFIs, including support for the development of commercially exploitable technologies designed to meet the needs of consumers in lower-income countries.

The new DFC needs the capacity to deliver these deals: both the tools provided by the BUILD Act which are being constrained by the administration and the staff and budget to actively build a pipeline of projects. At the moment, OPIC's portfolio per employee ratio is above \$80 million, compared to below \$20 million per staff member for the IFC, for example. The DFC's proposed administrative budget is less than ten percent of that of the IFC despite a similar potential size and a FY17 portfolio more than half of the size of the

---

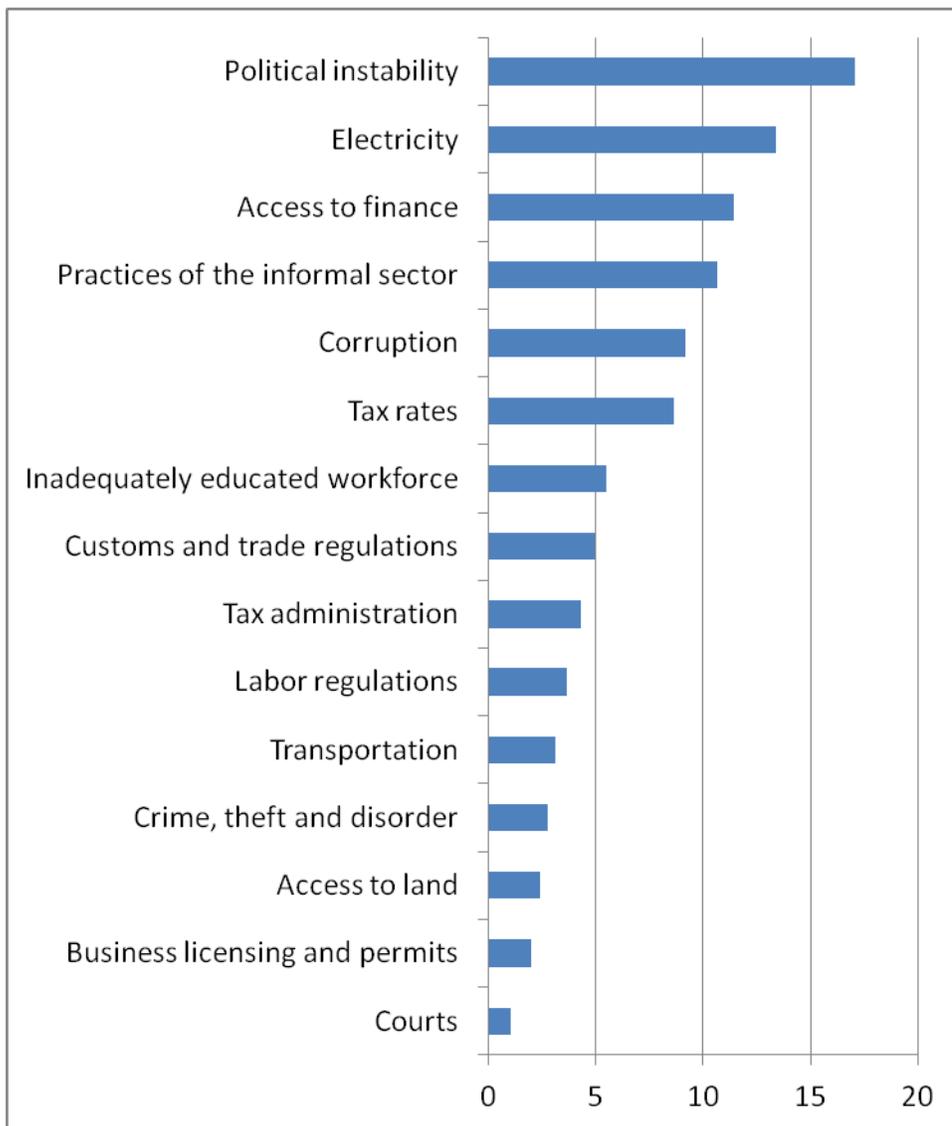
<sup>58</sup> See Kenny (2019).

IFC's.<sup>59</sup> A considerably bolstered administrative budget may involve reducing —potentially to zero—the profitability OPIC traditionally enjoyed.

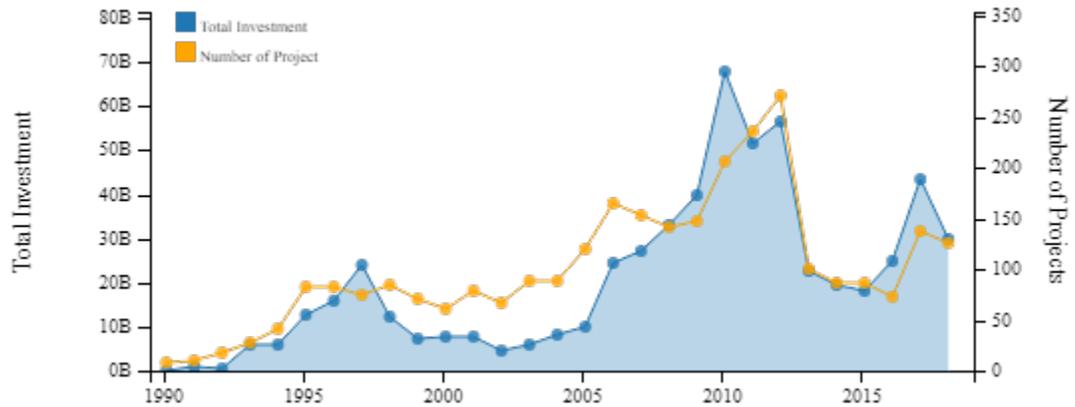
---

<sup>59</sup> IFC, 2019; Moss & Collinson, 2019 --indeed, include the IFC's total resources and they are \$1.7 billion compared to \$97 million budgeted to the DFC. IFC's portfolio in FY18 was \$42 billion (IFC, 2018). OPIC claims a portfolio of \$23 billion (OPIC, 2017)

**Figure One: Large (100+ Employees) Firms in LICs and LMICs: Greatest Constraint**



**Figure Two: Low and Low-Middle Income Infrastructure Projects with Private Participation**



**Table One: Large (100+ Employees) Firms in LICs and LMICs: Characteristics**

Percent of firms with at least 10% of foreign ownership	31
Percent of firms with at least 10% of government/state ownership	5
Percent of firms with an internationally-recognized quality certification	38
Percent of firms with an annual financial statement reviewed by external auditors	74
Percent of firms not needing a loan	47
Percent of firms using banks to finance investments	29
Proportion of investments financed internally (%)	73
Proportion of investments financed by banks (%)	16
Percent of firms identifying access to finance as a major constraint	24

Source: Enterprise Survey Data

**Table Two: The Environment for Firms in Developing Countries**

	Low income	Lower middle income	Upper middle income	High income
Firms expected to give gifts in meetings with tax officials (% of firms)	22.2	17.8	9.6	1.5
Tariff rate, applied, simple mean, all products (%)	11.0	..	6.2	3.9
Logistics performance index: Overall (1=low to 5=high)	2.4	2.5	2.7	3.6
Firms experiencing electrical outages (% of firms)	75.6	61.9	48.6	29.1

**Table Three: Projected GDP of Low and Lower-Middle Income Countries**

	GDP (bn)	India %	GDP ex India
2017	6,554	39	3,973
2018	6,798	40	4,087
2019	7,121	40	4,275
2020	6,940	43	3,952
2021	5,978	52	2,840
2022	6,277	52	2,982
2023	6,559	53	3,099

	GDP (bn)	India %	GDP ex India
2017	6,554	39	3,973
2018	6,798	40	4,087
2019	7,121	40	4,275
2020	6,940	43	3,952
2021	5,978	52	2,840
2022	6,277	52	2,982
2023	6,559	53	3,099

## References

- Attridge, S., & Engen, L. (2019). Blended finance in the poorest countries. *Overseas Development Institute*, 76. Retrieved from <https://odi.org/sites/odi.org.uk/files/resource-documents/12666.pdf>
- Belda, H. J. (2016). Ethiopian Banking Sector Development. *Research Journal of Finance and Accounting*, 7(3), 25-30–30. Retrieved from <https://www.iiste.org/Journals/index.php/RJFA/article/view/28941>
- Brautigam, D., Diao, X., McMillan, M., & Silver, J. (2017). *Chinese Investment in Africa: How Much do we Know?* (No. 2). Retrieved from UKAID website: [https://pedl.cepr.org/sites/default/files/PEDL\\_Synthesis\\_Papers\\_Piece\\_No.\\_2.pdf](https://pedl.cepr.org/sites/default/files/PEDL_Synthesis_Papers_Piece_No._2.pdf)
- Bureau of Economic Analysis. (2017). GDP by Metropolitan Area. Retrieved August 21, 2019, from <https://www.bea.gov/data/gdp/gdp-metropolitan-area>
- Carter, P. (2018, February). The Pitfalls of Leverage Targets. Retrieved July 2, 2019, from Center For Global Development website: <https://www.cgdev.org/blog/pitfalls-leverage-targets>
- Corker, B. *BUILD Act*, Pub. L. No. S. 2463 (2018).
- Deloitte. (2018). *Africa Construction Trends 2018*. Retrieved from <https://www2.deloitte.com/za/en/pages/energy-and-resources/articles/africa-construction-trends-report.html>
- European Commission. (2018). Press release - Questions and answers: the EU budget for external action. Retrieved August 21, 2019, from European Commission website: [https://europa.eu/rapid/press-release MEMO-18-4124\\_en.htm](https://europa.eu/rapid/press-release_MEMO-18-4124_en.htm)
- Gavas, M., & Timmis, Hannah. (2019). *The EU's Financial Architecture for External Investment: Progress, Challenges, and Options*. 18.
- Horn, S., Reinhart, C. M., & Trebesch, C. (2019). *China's Overseas Lending* (Working Paper No. 26050). <https://doi.org/10.3386/w26050>
- IDA Resource Mobilization Department. (2016, September). Further Details on the Proposed IFC-MIGA Private Sector Window in IDA18. Retrieved July 1, 2019, from <http://documents.worldbank.org/curated/en/947651474898912390/pdf/IDA18-IFC-MIGA-Private-Sector-Window-FINAL-09232016.pdf>
- Independent Commission for Aid Impact. (2019). CDC's investments in low-income and fragile states. Retrieved August 21, 2019, from ICAI website: <https://icai.independent.gov.uk/report/cdc/>
- Independent Evaluation Group. (2017). *The International Finance Corporation's Approach to Engaging Clients for Increased Development Impact*. Retrieved from <https://ieg.worldbankgroup.org/evaluations/ifc-client-engagement>
- Ingram, G., & Mosbacher, Jr., R. A. (2018, July 31). Development finance: Filling today's funding gap. Retrieved August 14, 2019, from Brookings website: <https://www.brookings.edu/research/development-finance-filling-todays-funding-gap/>
- International Finance Corporation. (2017). Financials 2017. Retrieved August 21, 2019, from <https://www.ifc.org/wps/wcm/connect/c87111c4-1064-4308-a5d9-983a506c81c3/IFC-AR17-Vol-2-Financials.pdf?MOD=AJPERES&CVID=IXabor3>

- International Finance Corporation. (2018). Financials 2018. Retrieved August 21, 2019, from [https://www.ifc.org/wps/wcm/connect/CORP\\_EXT\\_Content/IFC\\_External\\_Corporate\\_Site/Annual+Report/AR18-Home](https://www.ifc.org/wps/wcm/connect/CORP_EXT_Content/IFC_External_Corporate_Site/Annual+Report/AR18-Home)
- International Finance Corporation. (2019). FY20 IFC Budget. Retrieved August 21, 2019, from <https://www.ifc.org/wps/wcm/connect/4b91247c-e00d-46ec-95ab-3480e004c564/FY20-IFC-Budget-Paper.pdf?MOD=AJPERES&CVID=mNivHkv>
- International Monetary Fund African Department. (2016). *United Republic of Tanzania : Selected Issues-Macrofinancial Issues*. Retrieved from IMF website: <https://www.imf.org/en/Publications/CR/Issues/2016/12/31/United-Republic-of-Tanzania-Selected-Issues-Macrofinancial-Issues-44139>
- Kenny, C., Kalow, J., Leo, B., & Ramachandran, V. (2018). *Comparing Five Bilateral Development Finance Institutions and the IFC*. Retrieved from <https://www.cgdev.org/publication/comparing-five-bilateral-development-finance-institutions-and-ifc>
- Kenny, C., Kalow, J., & Ramachandran, V. (2018, January). Inside the Portfolio of the International Finance Corporation: Does IFC Do Enough in Low-Income Countries? Retrieved July 2, 2019, from Center For Global Development website: <https://www.cgdev.org/publication/inside-portfolio-international-finance-corporation-does-ifc-do-enough-low-income>
- Leo, B., & Moss, T. (2016). *Inside the Portfolio of the Overseas Private Investment Corporation*. 41.
- McKinsey & Company. (2016). *Lions on the Move II*. Retrieved from McKinsey Global Institute website: [https://www.mckinsey.com/~/\\_/media/McKinsey/Featured%20Insights/Middle%20East%20and%20Africa/Realizing%20the%20potential%20of%20Africas%20economies/MGI-Lions-on-the-Move-2-Executive-summary-September-2016v2.ashx](https://www.mckinsey.com/~/_/media/McKinsey/Featured%20Insights/Middle%20East%20and%20Africa/Realizing%20the%20potential%20of%20Africas%20economies/MGI-Lions-on-the-Move-2-Executive-summary-September-2016v2.ashx)
- McKinsey & Company. (2018). The overlooked revolution for business in Africa. Retrieved August 2, 2019, from McKinsey Quarterly website: <https://www.mckinsey.com/featured-insights/middle-east-and-africa/africas-overlooked-business-revolution>
- Medina, L. R., Jonelis, A. W., & Cangul, M. (2017). *The Informal Economy in Sub-Saharan Africa : Size and Determinants*. <https://doi.org/10.5089/9781484305942.001>
- Ministry of Statistics and Programme Implementation. (2017). Percentage Share of GVA by economic activity. Retrieved August 7, 2019, from Government of India website: [http://www.mospi.gov.in/sites/default/files/reports\\_and\\_publication/statistical\\_publication/National\\_Accounts/NAS18/S1.6A.pdf](http://www.mospi.gov.in/sites/default/files/reports_and_publication/statistical_publication/National_Accounts/NAS18/S1.6A.pdf)
- Moss, T., & Collinson, E. (2019). USDFC Monitor: Why Is the White House Scuttling its Biggest Development Win? Four Hidden Daggers Pointed at the Heart of the New USDFC. Retrieved August 2, 2019, from Center For Global Development website: <https://www.cgdev.org/blog/why-white-house-scuttling-its-biggest-development-win-four-hidden-daggers-pointed-heart-new>
- Online Currency Converter. (2015). United States dollar (USD) and Tanzanian shilling (TZS) Exchange Rate History. Retrieved August 9, 2019, from <https://freecurrencyrates.com/en/exchange-rate-history/USD-TZS/2015>
- OPIC. (2018). Annual Reports. Retrieved August 21, 2019, from <https://www.opic.gov/media-events/annual-reports>

- Overseas Private Investment Corporation. (2017). OPIC Announces \$3.8 Billion in New Commitments in Fiscal Year 2017. Retrieved August 21, 2019, from <https://www.opic.gov/press-releases/2017/opic-announces-38-billion-new-commitments-fiscal-year-2017>
- Page, J., & Söderbom, M. (2015). Is Small Beautiful? Small Enterprise, Aid and Employment in Africa. *African Development Review*, 27(S1), 44–55. <https://doi.org/10.1111/1467-8268.12138>
- Poschke, M. (2018). The Firm Size Distribution across Countries and Skill-Biased Change in Entrepreneurial Technology. *American Economic Journal: Macroeconomics*, 10(3), 1–41. <https://doi.org/10.1257/mac.20140181>
- Pound Sterling Live. (2014). US Dollar to Ethiopian Birr Exchange rate history: 14 March 2014 (14/03/2014). Retrieved August 9, 2019, from PoundSterling Live website: <https://www.poundsterlinglive.com/best-exchange-rates/us-dollar-to-ethiopian-birr-exchange-rate-on-2014-03-14>
- Price Waterhouse Coopers. (2019). *2018 Africa capital markets watch*. Retrieved from Price Waterhouse Coopers website: <https://www.pwc.com/ng/en/publications/africa-capital-markets-watch.html>
- Ramachandran, V., & Kenny, C. (2018). The International Finance Corporation’s Mission Is Facilitating Risky Investments—So Why Is It Taking on Less and Less Risk? Retrieved August 21, 2019, from Center For Global Development website: <https://www.cgdev.org/blog/international-finance-corporation-mission-facilitating-risky-investments-so-why-it-taking>
- Runde, D., & Milner, A. (2019). *Development Finance Institutions: Plateaued Growth, Increasing Need*. Retrieved from Center for Strategic & International Studies website: <https://www.csis.org/analysis/development-finance-institutions-plateaued-growth-increasing-need>
- Sandefur, J. (2010). *On the Evolution of the Firm Size Distribution in an African Economy* (No. 2010–05). Retrieved from Centre for the Study of African Economies, University of Oxford website: <https://ideas.repec.org/p/csa/wpaper/2010-05.html>
- S&P Global Ratings. (2019). Sovereign Risk Indicators. Retrieved August 21, 2019, from <https://www.spratings.com/sri/>
- Sun, I. Y., Jayaram, K., & Kassiri, O. (2017). *Dance of the lions and dragons How are Africa and China engaging, and how will the partnership evolve?* Retrieved from McKinsey Global Institute website: <https://www.mckinsey.com/featured-insights/middle-east-and-africa/the-closest-look-yet-at-chinese-economic-engagement-in-africa>
- Sutton, J., & Kellow, N. (2010). *An Enterprise Map of Ethiopia*. International Growth Centre.
- US Small Business Administration. (2019). Firm Size Data. Retrieved August 9, 2019, from Small Business Association website: <https://www.sba.gov/advocacy/firm-size-data>
- Van Biesebroeck, J. (2005). Firm Size Matters: Growth and Productivity Growth in African Manufacturing. *Economic Development and Cultural Change*, 53(3), 545–583. Retrieved from <https://ideas.repec.org/a/ucp/ecdecc/y2005v53i3p545-83.html>
- World Bank. (2010). *IFC ROAD MAP FY11-13*. Retrieved from [https://www.ifc.org/wps/wcm/connect/bfdd11804152a12ba5a9a79e78015671/FY11\\_13\\_IFC\\_Road\\_Map.pdf?MOD=AJPERES](https://www.ifc.org/wps/wcm/connect/bfdd11804152a12ba5a9a79e78015671/FY11_13_IFC_Road_Map.pdf?MOD=AJPERES)

- World Bank. (2015). Tanzania Enterprise Survey 2013. Retrieved August 9, 2019, from World Bank Microdata Library website:  
<https://microdata.worldbank.org/index.php/catalog/1979>
- World Bank. (2016a). Ethiopia Enterprise Survey 2015. Retrieved August 9, 2019, from World Bank Microdata Library website:  
<https://microdata.worldbank.org/index.php/catalog/2577/related-materials>
- World Bank. (2016b). *IFC Strategy & Business Outlook FY17-19 : responding to economic volatility* (No. 106493; pp. 1–82). Retrieved from The World Bank website:  
<http://documents.worldbank.org/curated/en/430291467995619250/IFC-Strategy-Business-Outlook-FY17-19-responding-to-economic-volatility>
- World Bank. (2016c). World Development Indicators. Retrieved August 13, 2019, from <https://databank.worldbank.org/reports.aspx?source=2&series=NY.GDP.MKTP.CD&country=>
- World Bank. (2019a). World Bank Country and Lending Groups. Retrieved August 8, 2019, from <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups>
- World Bank. (2019b). World Development Indicators. Retrieved August 13, 2019, from <https://databank.worldbank.org/source/world-development-indicators>
- Zhang, J. (2019). Will the Manufacturing Growth Cycle Continue in China? Retrieved September 9, 2019, from <https://www.interactanalysis.com/china-manufacturing-growth-part-2/>