Incentivising Investment in Human Capital through the European Fund for Sustainable Development

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Abstract

As the EU prepares to significantly scale up its deployment of blended finance, guarantees, and other risk-sharing tools aimed at stimulating investment in developing countries, and, in the face of spiralling needs as a result of COVID-19, this paper analyses how the EU could use its development budget to incentivise private investment in human capital. The paper provides three contributions. First, it gives an overview of the allocation of the EU’s external investment to date. Second, based on interviews with stakeholders, it documents cases of private investment in health and education while exploring some of the barriers to a higher share of investment in these sectors by the EU and its development finance partners. Finally, it puts forward a set of proposals for how to steer greater European external investment through the European Fund for Sustainable Development Plus (EFSD+) toward human capital.
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The COVID-19 crisis has compelled the European Union (EU) to return to its social market economy credentials in its external assistance. In the pre-COVID-19 era, in the face of spiralling investment needs that continually outstripped constrained grant budgets, externally funded economic infrastructure with “blended” uses of aid-funded subsidies, equity, and other public support (like guarantees as catalysts for private, largely debt-funded sources) gained prominence. This was, however, at the expense of investments in human development. While economic growth and job creation are critical for development, investing in human development, and thus, human capital, is a necessary condition to support productive activities. The pandemic has now reinforced the strong correlation between human development and economic development and the need to invest in human capital as a key ingredient to trigger sustained economic growth. And it has revived the notion that a society can function only as well as the most vulnerable groups within it are protected.

Unlike other key sectors that benefit from external finance, private sector funding is unlikely to be the most important source of finance for social services. Some developmental projects can attract private finance relatively easily, such as investment in factories and other capital that can simultaneously provide employment opportunities and returns for investors. Others are likely to have a direct effect on economic activity and future government revenues—such as infrastructure investments—and therefore can attract private finance in the form of partnerships with the private sector or can make debt financing a more viable proposition. Returns to social sector investments are long-term and the fiscal returns may not fully reflect the broader benefits to society. This dis-incentivises borrowing for social sector investment.

Development finance institutions (DFIs) and multilateral development banks (MDBs) have already significantly scaled up support and collaboration to respond to COVID-19 in developing countries. They have, collectively, announced their intention to “promote new investment in global health, safety, and economic sustainability” as part of the crisis response. However, health and education continue to be underinvested in by the European DFIs and MDBs, more so than other sectors.

In the EU, experimentation with innovative modalities to finance public service delivery has been slow; social sectors have continued to rely more heavily on traditional grant financing. Only 3.3 percent of the €3.1 billion grant contribution to EU blended finance projects and only one guarantee out of 28 had been allocated to social sectors.

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1 Human development refers to the improvement of people’s wellbeing through health, education, and decent standard of living as well as the conditions that enable people to obtain these.
2 Human capital refers to the education and health people accumulate throughout their lives, viewing them as productivity factors.
4 See statement from the DFI Alliance and pledge by 12 MDBs.
As the EU prepares to significantly scale up its deployment of blended finance, guarantees, and other risk-sharing tools aimed at stimulating investment in developing countries, and as it seeks to use its development budget to incentivise private investment in health and education, this paper provides three contributions. First, it gives an overview of the allocation of the EU’s external investment to date. Second, it explores some of the barriers to a higher share of investment in education and health by the EU and its development finance partners, including who should be funding social sectors and with what financial instruments; how to generate cash flows; and how to scale-up investments. Finally, it puts forward a set of proposals for how to steer greater European external investment through the European Fund for Sustainable Development Plus (EFSD+) toward health and education. What is clear is that having a highly discounted and easily accessible EU guarantee in the social sectors would go a long way towards lowering risk to a level where the private sector would invest. To steer and incentivise the DFIs and MDBs to branch out into health and education, we propose the establishment of a social policy investment window as part of the EFSD+. In terms of financial instruments, we suggest that, in addition to blended finance and guarantees, the European Commission (EC) could consider developing a suite of results-based financing tools to build upon and complement its traditional grant support for the social sectors, including research & development (R&D) prizes and development impact bond (DIBs). To generate a pipeline of projects in the social sectors, we recommend the establishment of an “accelerator hub” that would provide targeted support to identify, prepare, and develop investment projects in social sectors. And finally, we suggest that the EC define social bond standard criteria to determine whether investments qualify as beneficial for human capital.

The analysis draws on documents available in the public domain and input from interviews with stakeholders. Interviewed stakeholders included representatives from the EC and the World Bank as well as partners currently engaged with the European Fund for Sustainable Development (EFSD): the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC), the Dutch Development Bank (FMO), the Agence Française de Développement (AFD) and the Bill and Melinda Gates Foundation (BMGF).

1. The EU’s External Investment Plan

In 2017, the EU launched its External Investment Plan to boost investment in its neighbouring countries and in Africa. At the centre of the plan is its financial arm, the European Fund for Sustainable Development (EFSD) composed of guarantees and blended finance instruments to facilitate investment and to act as a one-stop shop for all investors seeking financial support from the EU.
The €4.1 billion EFSD, of which €2.6 billion was allocated to the two regional investment Platforms—the African Investment Platform (AIP) and the Neighbourhood Investment Platform (NIP)—and €1.5 billion to the EFSD Guarantee, grew to €4.6 billion between 2017 and 2019.⁶ As illustrated in Figure 1, 12 financial institutions have engaged in at least one EFSD guarantee or blending project, albeit with large differences in amounts.

**Figure 1. Share of EU contributions to guarantees and blending operations by EFSD implementing partners (2017-2020)**

From the €4.6 billion committed through the EFSD, the EC claims to have generated €47 billion in external financing.⁷ However, a study from the European Parliament also highlighted that this leverage ratio of 10 appears misleading as “external financing” also includes loans and grants from other DFIs or MDBs.⁸

As part of the EU’s new Multiannual Financing Framework (MFF) 2021-2027, the EC will expand the EFSD (EFSD+), increasing both financial scope and geographical coverage, with a new €53.4 billion External Action Guarantee (EAG). While the total amount dedicated to the EFSD+ is still under discussion, the fund will now cover all EU partner countries.

While the EFSD, with its risk-sharing tools, is an important innovation for mobilising investment, its potential is not being fully realised. Setting aside the operational, monitoring, and reporting challenges, two fundamental problems have emerged: (1) it has not managed

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⁵ Neighbouring countries of the EU include: Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Kyrgyz Republic, Lebanon, Libya, Moldova, Morocco, Palestine, Syria, Tunisia and Ukraine.

⁶ At the time of writing, the EIP claims to have allocated €5.1 billion.

⁷ See the [EFSD Operational Report 2019](#).

⁸ See study on “the use of development funds for de-risking private investment”.
to attract substantial private investment to low-income and fragile and conflict affected states, where the perceived risk is higher and where there is greater need for private investment, and (2) the current allocations have concentrated in economic development sectors such as energy, infrastructure, and private sector development. Only small amounts have been allocated to areas like sustainable cities, ICT, agriculture, and social sectors.\(^9\)

Between 2017 and 2019, €3.1 billion out of the €4.6 billion total had been allocated for blended finance operations—€1.3 billion for the EU neighbourhood and €1.8 billion for sub-Saharan Africa.\(^10\) Due to differences in risk-profiles between the two regions, the neighbourhood had a leverage ratio of 1:12 while in sub-Saharan Africa, it was 1:7.\(^11\)

**Figure 2. Geographic distribution of EU blending activities and mobilised amounts (2017–2019)**

![Figure 2](image)


In terms of sector allocation, a majority of the blended finance has been concentrated in infrastructure projects in the transport (30.3 percent) and energy (27.3 percent) sectors. Only 3.3 percent of blended finance activities were in the social sectors. In total, six projects in education were signed with co-financing from EFSD partners worth €119 million. Out of these six projects, three were led by the French Development Agency (AFD), two by the European Investment Bank (EIB) and one by the German Development Bank (KfW).

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\(^9\) See the Implementation Report of the EFSD and the EFSD Guarantee Fund.

\(^10\) See the EFSD Operational Report 2019.

\(^11\) Ibid.
In terms of guarantees, five investment windows were designed to attract investment in energy and connectivity, small- and medium-sized enterprises, agriculture, sustainable cities, and digitalisation. Out of these five windows, only one (digitalisation) makes specific reference to health and education in its policy objectives. The European Health Guarantee Platform for Africa was signed under this digitalisation window in 2018. Led by the EIB, the guarantee is managed in close cooperation with the BMGF. The objective of the project is to strengthen diagnostic services for low-income populations in sub-Saharan Africa. The EFSD guarantee could reach up to €80 million in the project, with the objective of mobilising investment from private stakeholders in laboratory facilities for diseases such as tuberculosis, HIV, and malaria. To respond to the COVID-19 pandemic, the amount available was significantly increased to €438 million, with up to €400 million for the procurement of vaccines in sub-Saharan Africa and the EU neighbourhood, and up to €38 million covering the risk of non-payment of governments in sub-Saharan Africa to private sector laboratory and diagnostic companies.

Table 1 shows the limited investment in human capital from the users of the EFSD in 2019, in contrast to their total portfolios. However, it should be noted that, in the absence of a harmonised reporting framework, it is difficult to form an accurate view. In the next section of this paper, we investigate the current barriers to investments in human capital.

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2. Obstacles to investing in social sectors

Evident from the interviews with EFSD partners, the pandemic has clearly shifted the narrative on investing in social sectors, and healthcare in particular. As the pandemic hit, a range of DFIs began to shift their financial firepower towards the fight against COVID-19. Overall, international financial institutions (IFIs) have proven to be more flexible than bilateral donors in deploying resources to respond to the pandemic. Figure 4 illustrates that in 2020, four IFIs (the World Bank, the African Development Bank, the Asian Development Bank, and the Inter-American Development Bank) significantly ramped up their commitments to human capital. Others did too. For example, the IFC launched a US$4 billion global health platform to increase the production of healthcare supplies such as masks, ventilators, and test kits in developing countries, while the EBRD provided additional funding to existing clients to increase their capacity to treat COVID-19 patients. On the whole, there was consensus amongst the stakeholders about the need to ramp up investments even further in health and education in the coming years.

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13 Understood as investment in health, education, job training and other social infrastructure.
14 Fiscal Year (June 2018-July 2019).
15 Investments and Portfolio figures outside of the European Union.
16 The views presented were provided by a range of stakeholders, which are listed in the Annex.
18 See EBRD’s COVID response in Georgia and Turkey.
However, a number of challenges were raised, including questions regarding who should be funding social sectors and with what financial instruments, how to generate cash flows, and how to scale up investments.

Below, we examine each of these challenges in turn, and offer innovative examples from a selection of DFIs and MDBs of how they have overcome the obstacles.

**The public vs. private sector dilemma**

There is no consensus among DFI/MDB staff on the question of which type of funding is best suited to achieve social progress in health and education. For certain institutions, the latter should remain exclusively in the public domain. These DFIs/MDBs argue that grants, rather than blended finance or guarantees, are the appropriate instruments to finance these sectors, and the general lack of expertise and experience in health and education has meant that they have struggled to design financial products prone to attracting private investors.

Indeed, the evidence shows that the social sectors—particularly education—have tended to be supported either by public taxation or grants, rather than loans.20

In some cases, there has been an attempt to create niche areas for IFI engagement, for example, through supporting higher education rather than basic education, or supporting public private partnership (PPP) hospitals rather than primary health care. These strategic choices suggest that bilateral donors should be funding these sectors.

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19 See the policy brief for the full list of bilateral donors and IFIs included in the data.
However, recent studies continue to highlight the gap between current funding and needs to achieve sustainable development goals (SDGs) three and four.\textsuperscript{21} According to their model, Stenberg et al. estimate that US$371 billion will be needed annually to achieve SDG three related to good health and well-being. The authors conclude that while middle-income countries (MICs) are well equipped to self-finance their needs, the burden mostly lies on low-income countries (LICs). To achieve SDG four by 2030, UNESCO estimates that US$504 billion will be needed on an annual basis, an increase from US$340 billion in 2015. With constrained domestic and external public flows amid a global pandemic, there is no doubt that private sector investment will be needed to help bridge these gaps.

Furthermore, in some cases, the private sector may provide genuine value to health and education systems while directly benefiting their business strategies. The private sector may have an advantage over the public sector in terms of skills and operational expertise that it could bring to the table. And it fills important gaps in health and education services and products to those underserved by the public sector as well as offering the potential to increase the scale and scope of the services.\textsuperscript{22}

Given the absolute imperative of strengthening developing country public health and social support capacities as a result of the pandemic, we have seen an increase in investment in health, albeit largely concentrated in upper-middle-income countries and generally directed towards for-profit hospitals and clinics, pharmaceutical manufacturing, and financial services for health (like insurance).\textsuperscript{23} This includes financing laboratories and diagnostic centres as an alternative to national health services, which often lack the quality and staff required. India has pioneered an interesting model on private sector driven hospitals which offer complex medical services, but with questions around affordability and accessibility. The Indian National Health Policy explicitly acknowledges the role of the private sector in filling the gaps in public health facilities. The policy highlights the relevance of public-private collaborations in several public health priorities including capacity building, skills development programmes, corporate social responsibility (CSR), mental health, disaster management, immunization, disease surveillance, medicine manufacturing, and tissues and organ transplants.\textsuperscript{24} In sub-Saharan Africa, access to reliable diagnosis remains an issue as does the lack of harmonisation of health laboratories which is essential for strengthening health systems. Yet, other potential investment areas have remained largely neglected across the health sector—including those, like medical equipment, with direct relevance to the COVID-19 response.

\textsuperscript{21} See an analysis by Stenberg et al. (2017) and policy paper by the Global Education Monitoring Report from UNESCO (2020).
\textsuperscript{22} See: https://www.cgdev.org/blog/unchained-melody-role-private-school-chains-developing-countries.
\textsuperscript{24} See 2017 Indian National Health Policy.
\textsuperscript{25} See paper by Putoto et al. (2015) and paper by Alemnji et al. (2014).
Box 1. An example of investment in diagnostic services

In 2020, the International Finance Corporation provided a US$8.35 million loan to Cerba Lancet Africa, a network of clinical laboratories across Sub-Saharan Africa. Present in 12 African countries, the company provides diagnostics to 1.3 million patients a year. The loan provided by IFC will be used to increase the number of collection points for clinical tests in suburban areas. IFC claims that its investment in Cerba Lancet Africa is additional due to the financing structure of the deal, the capacity to mobilize additional resources and the non-commercial risk mitigation factor.


Education finance has traditionally been left to the public sector. In LICs and MICs, education spending usually represents a larger share of the government budget than in high income countries (HICs). As shown in Figure 6, between 2009 and 2017, LICs and MICs spent between 15 percent and 16 percent of their public expenditures on education, while HICs disbursed between 12 percent and 13 percent. Nevertheless, private investors are increasingly looking at how to complement governments’ initiatives to strengthen education systems. One area where DFIs have started to become more active is in vocational training to tackle youth unemployment. In 2015, the French DFI, Proparco, invested in a hotel school in Mali to train young people in hospitality jobs. In the school, students divide their time between learning and working for the partner hotel chain.26

Figure 5. Government expenditure on education, total (% of government expenditure)

Source: World Bank27

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26 See https://www.proparco.fr/fr/actualites/grand-angle/lecole-hoteliere-chiaka-sidibe.
27 Data for Middle-Income countries not available for 2015.
Box 2. A public-private partnership to increase access to education and combat child labour

The Child Learning and Education Facility was launched in 2020 to increase access to early education as a way to fight child labour in Côte d’Ivoire. The target capitalisation of the facility is CHF150 million. The financing facility was built as a partnership between the Jacobs Foundation, the UBS Foundation, the government of Côte d’Ivoire, and 11 cocoa and chocolate companies. It aims to create 10,000 primary schools in cocoa growing areas and to construct 2,500 classrooms and other education infrastructure. This multi-stakeholder engagement over 10 years represents a win-win opportunity for the public and private sector in addressing a social challenge while guaranteeing a fair supply chain in the cocoa industry.


Generating a pipeline and cash flows

Investments in infrastructure, such as energy or transport, have a clear cost-benefit rationale. They produce mainly economic returns and are thus more likely to attract private finance to complement public resources. This is because economic outcomes are much easier to monetise than social ones. So, the outcome of a project to build a bridge is easier to observe and measure than the outcome of a project to prevent girls dropping out of school.

A majority of the DFIs/MDBs interviewed highlighted the lack of a pipeline of financially sustainable projects in health and education. They argue that it remains difficult to convince private investors to engage in areas for which returns are longer term and business models are riskier than for energy and transport projects. Increasingly, however, many private sector investors are seeking investments that meet both financial objectives and nonfinancial objectives. These investment strategies include sustainable finance, environmental, social, and governance (ESG) investment, responsible investment, impact investment, and green finance. While different in mandate and scope, these investment strategies aim to achieve positive social, environmental, or developmental outcomes in addition to financial returns.

In recent years, several examples have demonstrated the potential of combining financial returns and development impact in social sectors through results-based financing. By monetising social outcomes, social problems could be transformed into “investable” opportunities, thereby attracting private capital.
Box 3. A social enterprise to improve learning outcomes in the MENA region

Since late 2018, the EBRD Star Venture programme funded by the EU and multilateral donors has been supporting local accelerators and high potential start-ups in the Southern Neighbourhood region and the Western Balkans region with an expansion planned to Turkey and the Eastern Neighbourhood region. The Star Venture programme provides customised business diagnostics to identify top business priorities for start-ups and leverages a dedicated network of mentors and advisers. It also connects start-ups to a network of investors and corporations with a strategic interest in the early-stage space to facilitate their access to innovation and technology across different sectors. In the social sector, for example, Star Venture has supported Little Thinking Minds (LTM), a multiple award-winning edtech start-up in Jordan that creates online educational platforms for advanced Arabic language learning. LTM’s platforms are being used by more than 250 public and private schools across the MENA region with over 130,000 students worldwide including refugee children through remedial school programs. Star Venture’s advisory project has been supporting LTM’s new B2C marketing strategies and campaigns since 2020.

Source: EBRD Start Venture programme.

The UK’s Commonwealth Development Corporation (CDC) has proposed an innovative way of financing healthcare in LICs and MICs. As part of its catalyst strategies to address a specific need within a sector, it invested in MedAccess, a social company focused on increasing patient access to medical supplies. To reach underserved populations, MedAccess uses tools such as volume and procurement guarantees to secure stable supplies at a low price. The key feature of MedAccess lies in its sustainable business model. Following an initial investment of US$200 million investment by CDC in 2017, the social finance company is now financially self-sufficient. In response to COVID-19, MedAccess has partnered with UNICEF to guarantee diagnostic tests and clinical management supplies for LMICs.

28 See MedAccess’ website.
Box 4. Combining financial returns and development impact: an example of a DIB

The Quality Education India Development Impact Bond (DIB) was created in 2018 expanding on the success of the Educate Girls DIB. Composed of 12 stakeholders, the governance structure of the DIB consists of the private sector, a development agency (UK Foreign and Commonwealth Development Office—formerly the Department for International Development) and private foundations. For a total value of $11.2 million, of which total outcomes funding reaches $9.2 million, the project aims to increase enrolment and learning results in Rajasthan, India. The UBS Optimus foundation is the main investor in the project. If the service providers underperform against pre-established targets regarding enrolment and learning results, the foundation risks losing money. If they perform above 120 percent of their targets, the foundation will receive a return on their investment (capped at 8 percent).

Source: Convergence.

Scaling up investments

DFIs and MDBs have struggled to mobilise finance on the scale required to meet development challenges. The latest development assistance committee (DAC) survey shows less than US$50 billion in mobilised private money in 2018, mostly in energy and banking, albeit double the amount registered in 2014. While collaboration with the private sector through blended finance instruments has increased, with COVID-19, the heightened risk makes it even more difficult.

Scaling up investments to have a transformative effect on social sectors was seen as a major challenge. Big social challenges require system transformation, which means that markets, the private sector, and DFIs/MDBs need to change what they do and how they interact. DFIs referred to the absence of a single platform as well as an established framework for social investment as a barrier to entry.

In other sectors, the EC has launched initiatives together with EDFI, the association of European development finance institutions, to finance early-stage innovations and help them grow. ElectriFI and AgriFI respectively in the energy and agriculture sectors are two examples of impact investment facilities combining technical assistance and risk capital. The strength of these two facilities lies in their targeting of early-stage funding, thereby creating a pipeline for scalable projects. The EC is also setting up an EU green bond standard to help the market develop and catalyse investments that have a positive impact on the environment.

See ElectriFI and AgriFI.
Box 5. A marketplace to scale up innovation

In 2016, the United States Agency for International Development (USAID) teamed up with the Norwegian Agency for Development Cooperation (NORAD) and the Bill & Melinda Gates Foundation (BMFG) to create a place for innovation linked to the issue of maternal death and infant mortality. Every Woman Every Child (EWEC) is an innovation support platform that manages a rolling health innovation portfolio. Projects are selected on the basis of their high potential to save and improve the lives of women and children in low- and middle-income countries and their likelihood to scale sustainably for long-term impact. The EWEC Innovation Marketplace currently supports 52 portfolio companies operating in over 29 countries. The Innovation Marketplace’s proven approach has helped empower its portfolio to successfully raise $32 million in growth capital and grants for projects aimed at advancing their impact goals.


3. Proposals for the EU’s new investment framework

While the EC has a long tradition of providing grants to social sectors, it is now exploring how to use its development budget to incentivise private investment in health and education in developing countries.

To date, the EFSD has had some success in incentivising coordination and joint initiatives between DFIs—both bilateral and multilateral—within and outside Europe. The EC has actively encouraged them to collaborate and partner in their applications to the fund, leading to higher quality proposals as they have combined their different skills and experiences in complementary formations. Going forward, this role will be even more crucial, given the general lack of expertise in the health and education space amongst the bilateral and multilateral DFIs. The EC has an important role to play in teaming them up with more experienced actors, across the scientific, technology, philanthropic and aid communities to ensure their investments can deliver the best solutions to current and future social challenges.

Below, we put forward a set of proposals for how the EC could overcome the barriers highlighted above and steer greater external investment towards health and education through the EFSD+. We suggest that the EC take a leaf from its own internal investment programme—InvestEU—in its design of the EFSD+. Like the EFSD+ for external investment, the InvestEU programme’s proposed financial arm—the InvestEU Fund—provides for a budget guarantee to facilitate internal investments. And similar to the EFSD+, the InvestEU Fund has a vital role to play in incentivising financial institutions to mobilise public and private investment, particularly for underinvested markets, to address market failures and investment gaps, and to adapt to changing policy priorities. The InvestEU Fund includes specific objectives on social investment that are reflected in a “social investment and skills” policy window with a specific amount earmarked for the window (€2.8 billion.
It focuses, amongst other things, on social infrastructure, as well as social innovation, including innovative solutions and schemes aimed at promoting social impacts and outcomes in education and training. A similar policy investment window could be set up as part of the EFSD+ to steer and incentivise its implementing partners to branch out into health and education and to facilitate collaboration between them. The policy investment window could target both well-established actors who are seeking to expand operations as well as start-ups.

**Reconciling public and private sector investment in social sectors**

The private sector is not a replacement for effective public-sector action. In every setting, both sectors have roles to play in addressing the complex and difficult challenges faced by developing countries to expand access to high-priority health and education services to underserved populations.

Innovative finance mechanisms involving public finance in combination with DFI finance can monetise social benefits, so leveraging private investment. Mechanisms such as results-based aid, DIBs, advance market commitments, innovation funds, prizes, guarantees, debt buy-downs, and other instruments can help bring more finance into the social sectors. However, the EC should not rely entirely on market-shaping mechanisms, as these are not always appropriate in every sector and every context. Innovative financial products should not be developed at the expense of current grant funding in health and education. But, in partnership with DFIs and the private sector, the EC can test, develop, and scale these and other instruments, and so leverage the private sector’s financial resources, skills, innovation, flexibility, and its ability to bear and manage risk in social sector investments. It will, however, be important for the EC to ensure that private investment in a country’s social sectors does not replace public investment, but rather complements it. Private sector funded investments would need to demonstrate that they can match the affordability and increased accessibility offered by the public sector.

It will also be important for there to be much stronger coherence and knowledge sharing between the EC’s internal grant finance and private sector specialists. Presently, these two sit in separate units in the bureaucracy with little interaction between them. By better linking its grants and private sector instruments, the EC would be able to present a comprehensive offer covering both education and health systems as well as niche markets such as health- and edtech as well as job training schemes. In practice, grants could be used to support partner governments in creating the necessary regulatory frameworks for innovations in health and education to enter the market, while blended finance could be used to help companies grow in these sectors. One potential area of reform is procurement rules in the public health and education sectors. For example, the Global Innovation Fund provided grant funding to facilitate policy changes opening competition in the procurement of edtech

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software in India while also helping software companies to generate evidence around learning outcomes and to provide quality service at low costs. The EC could adopt a similar approach targeting (1) concrete policy changes, (2) evidence-building, and (3) support for the private sector.

**The EC could develop a suite of innovative financing tools to build upon and complement its traditional grant support for the social sectors.** The objective would be to promote innovation and reward high-impact projects. As high impact, successful interventions are proven, they can then be taken to scale.

R&D prizes can be set up to stimulate innovative solutions to complex predefined social problems. Under this scheme, the EC could work with partner governments to define an issue in health or education and provide an initial grant for competitors to cover set-up costs. The competitor presenting the innovation capable of generating the highest development impact at the lowest cost would then obtain a financial reward once the desired results are achieved. Whereas the European Innovation Council, established under the Horizon Europe programme, offers a similar scheme to support game-changing innovations focused on European issues, the EC’s Directorate-General for International Partnerships could use this experience to set up R&D prizes dedicated to solving social sector challenges in low- and middle-income countries.

The ESFD+ could also experiment with the use of DIBs for health and education. DIBs are outcome-oriented contractual arrangements that seek to incentivise performance in achieving measurable outcomes. At present, DIBs largely depend on philanthropic funding and mostly consist of small-scale projects absorbing large amounts for operational costs, including defining outcome metrics. In reaching critical mass, operational costs should decline, thereby allowing funds to be used to scale up investments. Coupled with technical assistance to help projects reach maturity stage, DIBs can be useful to attract private sector investors in developing countries’ underserved markets. In this regard, the EFSD+ could contribute towards shifting the focus from input to outcomes in human capital.

**Establishing an accelerator hub to generate a pipeline in social sectors**

The case for collaboration with a wide range of private and institutional investors could not be stronger given the scale and the risks inherent in the short- and longer-term responses to the crisis. Yet perceived risk continues to significantly impair private investment, compromising the quality of financial market information and lenders’ ability to assess the viability of companies and investment projects. If left unchecked, this can create pervasive risk aversion toward private investment projects and lead to a dearth of bankable projects. To generate investor interest (including from IFIs), what is needed is more access to risk

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reducing measures as well as more access to funding for project preparation. At the same time, presence on the ground is important for picking up opportunities that might otherwise be missed. With six offices in sub-Saharan Africa, the EIB could set up staff exchanges with European DFIs to allow them to build more intense knowledge of business dynamics in the region and develop additional relationships with local companies and entrepreneurs.

The EC provides technical assistance to support the development of bankable projects in partner countries. To date, €656 million in technical assistance for EFSD blended finance and guarantees and €3.8 billion for investment in policy dialogue on the business-enabling environment have been made available. However, this technical assistance does not explicitly cover the bulk of upstream costs, and the gap has been left to financial institutions and investors to fill.

To overcome this, the EC could establish an “accelerator hub” which would provide targeted support to identify, prepare, and develop investment projects in social sectors. Similar to the EBRD’s Infrastructure Project Preparation Facility (IPPF) which provides high-quality, client-oriented project preparation, policy support, and institutional strengthening, the accelerator hub could act as a single access point for technical assistance services. This online hub would be driven by experts from the EC, European development banks, national development banks, and private investors to work directly with investors and firms, offering tailor-made advice to dramatically accelerate the process of the development of a pipeline of high-quality projects in the social sectors. Experts would provide project development support throughout the stages of the project as well as upstream advice on market studies, sector strategies and project screening, financial advice to enhance companies’ ability to access adequate sources of financing, and advice about how to set up “investment platforms” to help finance smaller projects and bundle funds from different sources to enable diversified investments with a geographic or thematic focus. The ultimate aim would be to create the conditions to expand the potential number of eligible recipients in nascent markets.

Scaling up investments in the social sectors

As noted previously, current users of the EFSD lack clear guidelines on the type of investments capable of generating both financial and social returns. While the Social Bond Principles set guidelines to drive the provision of information needed to increase capital allocation to social projects, the criteria are both broad and vague (for example, access to essential services like health, education and vocational training, healthcare, financing, and financial services). The EC, as a standard setter, would be well-placed to define social bond standard criteria for an investment to qualify as beneficial for human capital.

To obtain the social bond standard, investors would need to specify how their investments are expected to generate positive outcomes in human capital. This framework could be based on the EU Green Bond Standard which is set to play an important role in defining the necessary criteria for an investment to be considered as providing “a substantial contribution to environmental objectives”. This new framework would have the double effect of steering DFIs/MDBs to invest in human capital and encouraging other investors to do so.

The EC could also launch an investment vehicle managed by the EDFI Management Company, to help DFIs scale up investments in the social sectors. As the EDFI Management Company is owned by six European DFIs, part of its value-add lies in its capacity to enter into high-risk markets and projects, especially those in which individual DFIs would not have been able to engage in on their own. This investment vehicle—“SocialFI”—could be modelled on ElectriFI and AgriFI which generate additional resources in the energy and agriculture sectors. The role of SocialFI would be to finance early-stage private companies and projects in health and education with a view to scaling up where successful. Niche markets such as health- and ed-tech as well as local pharmaceutical production could be the primary beneficiaries of SocialFI.

References


Annex 1. List of interviews

• International Finance Corporation (IFC)
• European Commission, Directorate-General for International Partnerships (DG INTPA)
• Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden (FMO)
• Agence Française de Développement (AFD)
• World Bank
• Bill and Melinda Gates Foundation
• European Investment Bank (EIB)
• European Bank for Reconstruction and Development (EBRD)