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OCCASIONAL PAPER SERIES N° 47

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SERIES
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Publisher

Southern Voice

Website: www.southernvoice.org

E-mail: info@southernvoice.org

First Published January, 2019

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ISSN 2307-9827 (Online)

ISSN 2307-681X (Print)

Preface

Southern Voice is a network of 50+ think tanks from Africa, Asia and Latin America.

Since its inception in 2012, it has served as an open platform. It provides structured inputs from the Global South into the debates on the 2030 Agenda, and the SDGs, with a view to addressing the 'knowledge asymmetry' and 'participation deficit' that usually afflict such global discussions.

In 2017, Southern Voice started to explore the use of blended finance as part of the strategies to finance the 2030 Agenda in Least Developed Countries (LDCs). It is a joint effort with the United Nations Capital Development Fund (UNCDF) and the United Nations Foundation. In this context, four country case studies, along with a synthesis paper, were carried out in Bangladesh, Nepal, Senegal and Uganda. These were inputs also for the UNCDF's report "Blended Finance in the Least Developed Countries," published in November 2018.

The present study constitutes a broad analysis of the application of blended finance in Senegal. It looks into the circumstances and conditions under which the instrument of blended finance allows for the mobilization of investments in projects and programs that may promote the implementation and achievement of the Sustainable Development Goals (SDGs). The study offers concrete and actionable recommendations for LDCs to take advantage of blended finance, a new and innovative financing instrument.

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Abstract

This research paper looks at the application of blended finance in Senegal. Southern Voice analysed the scope and magnitude of the use of the blended finance instrument including in the policy, regulatory and institutional realm. In addition, there has been a change in the government's focus from a purely grant based donor approach to a combination of public and private donors to finance the SDGs.

Southern Voice conducted a qualitative inquiry. It surveyed key players involved in the implementation of the Sustainable Development Goals (SDGs) and the development finance in Senegal. Among those actors are: commercial banks, private equity funds, sovereign funds, strategic investments backed by the Government of Senegal, and Aid or Donor agencies.

Our findings conclude that Senegal has made use of blended finance for development through initiatives such as the Senegal Strategic Investment Fund (FONSIS). As part of the development finance toolbox, the blended finance instrument is the heart of the public-private partnership strategy in key sectors like health, water, energy and infrastructure. At the institutional level, reforms are still needed to enable financial arrangements and encourage the private sector to get involved from the very beginning of the projects' life cycle. Major donor agencies and philanthropic funds are still missing players in Senegal, but their cooperation and engagement are vital.

Author

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Acronyms

AfDB	African Development Bank
AFD	French Development Agency - Agence Française de Développement
APIX	National Agency for the Promotion of Investments and Large-scale Infrastructure Projects - Agence nationale pour la promotion des investissements et des grands travaux
BCEAO	Central Bank of West African States - Banque Centrale des Etats de l'Afrique de l'Ouest
BOAD	West African Development Bank - Banque Ouest-Africaine de Développement
CBAO	Banking Company from West Africa - Compagnie Bancaire d'Afrique de l'Ouest
DC	Developing Country
DEG	German Investment Corporation - Deutsche Investitions - und Entwicklungsgesselschaft
DFI	Development Finance Institution
ECOWAS	Economic Community of West African States
EIB	European Investment Bank
FMO	Netherlands Development Finance Company - Financierings-Maatschappij voor Ontwikkelingslanden
FONGIP	Priority Investment Guarantee Fund - Fonds de Garantie des Investissements Prioritaries
FONSIS	Sovereing Fund for Strategic Investment - Fonds Souverain d'Investissements Stratégiques
ICD	Investment Corporation of Dubai
IFC	International Finance Corporation

IMF	International Monetary Fund
IsDB	Islamic Development Bank
LDC	Least Developed Country
OECD	Organisation for Economic Co-operation and Development
OECD DAC	OECD Development Assistance Committee
OPIC	Overseas Private Investment Corporation
PSE	Plan for an Emergent Senegal - Plan Sénégal Émergent
SDGs	Sustainable Development Goals
SDF	Sovereign Development Funds
SME	Small and Medium-Sized Enterprises
SONES	National Society of Exploitation of the Waters of Senegal
UNCDF	United Nations Capital Development Fund
UNICEF	United Nations International Children's Emergency Fund
USAID	U.S Agency for International Development
WB	World Bank

Blended finance in the national planning processes and the SDGs in Least Developed Countries: Evidence from Senegal

Seydina O Sene

Introduction

In Senegal financing the projects and programs aligned with the ambitious agenda of the Sustainable Development Goals (SDGs) is an enormous challenge for the government. Therefore, examining the potential of blended finance in developing countries such as Senegal and filling the data and evidence gap is a paramount interest of policymakers and practitioners around the world.

Blended finance in this research refers to the strategic use of aid resources to attract, leverage, and mobilise additional private and/or commercial capital for investments in sustainable development projects like those related to the SDGs, both domestically and internationally. However, well informed decision-making on the potential role of blended finance in LDCs is usually scant and therefore, requires data and evidence on the ground.

The objective of this study is to contribute to the policy debate on blended finance by documenting and sharing empirical evidence on how blended finance can be used in Senegal to diversify risk and attract private capital to support the implementation of the SDGs. Thus, IPAR, a regional Think Thank in West Africa, aims to provide with an overview of the application of blended finance in Senegal. This case study addresses the question of how blended finance is being adopted in Senegal to support the implementation and achievement of the SDGs. In addition, this paper analyses the conditions under which blended finance is an appropriate instrument in the broader development finance framework to mobilise private investments for project and programs targeting sustainable development in Senegal.

Methodologically, this research is mostly based on qualitative data from interviews with key actors currently or previously involved in the conceptualisation, development, and adoption of blended finance on specific projects and programs regarding SDGs in Senegal[1]. We categorised the analysed actors into three categories: a) private sector, which includes commercial banks, and private equity funds, b) international or bilateral donors, and c) government agencies.

To understand the role of the private sector we first focused on the largest commercial banks in Senegal (Ecobank, Bank of Africa, Citi, Senegal, Microcred, CBAO, and Orabank). Within the private equity funds group, we targeted key players such as AFIG Funds, which manages two funds plus a Senegalese portfolio of companies; Brightmore, an impact fund targeting SDG-focused investments; and Terranga Capital Dakar.

On the international/bilateral donors and government's agencies category we interviewed representatives from the IsDB (Islamic Development Bank), FONGIP (Priority Investment Guarantee Fund), FONSIS (Sovereign Fund for Strategic Investment), MEF (Ministry of Finance), the Ministry of Investment Promotion, Partnerships and Development of Teleservices, APIX Senegal (National Agency for the Promotion of Investments and Large-scale Infrastructure Projects), BOAD (West African Development Bank), AfDB (African Development Bank), IFC (International Finance Corporation), UNICEF, and AFD (French Development Agency). In addition, follow-up interviews were conducted with people who were identified as important actors by the main stakeholders.

As part of the analysis, this paper looked into existing blended finance instruments, mechanisms and structures. This research analysed instruments such as equity, debt, mezzanine, guarantees, insurance, hedging strategies, grants, and technical assistance; intermediation of instruments such as funds, syndication, securitisation, and PPPs; and barriers in specific sectors such as education, health, agriculture and agri-business, water, and sanitation.

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1 A complete list of the institutions analysed for this study is provided in Appendix I.

The next section of this study provides with an overview of the financial flows to Senegal and the role of blended finance in the context of development finance. This section also discusses policy and institutional frameworks by examining policies, practices, and the roles of main actors involved in blended finance (public and private, domestic and international or bilateral donors). The third section presents examples of blended finance initiatives and specific projects in Senegal. The fourth section, describes the level of involvement of the domestic private sector in the use of blended finance. The fifth section analyses the development impact and domestic capacity of generating wider blended finance instruments. The last section of the research presents the main findings of this study.

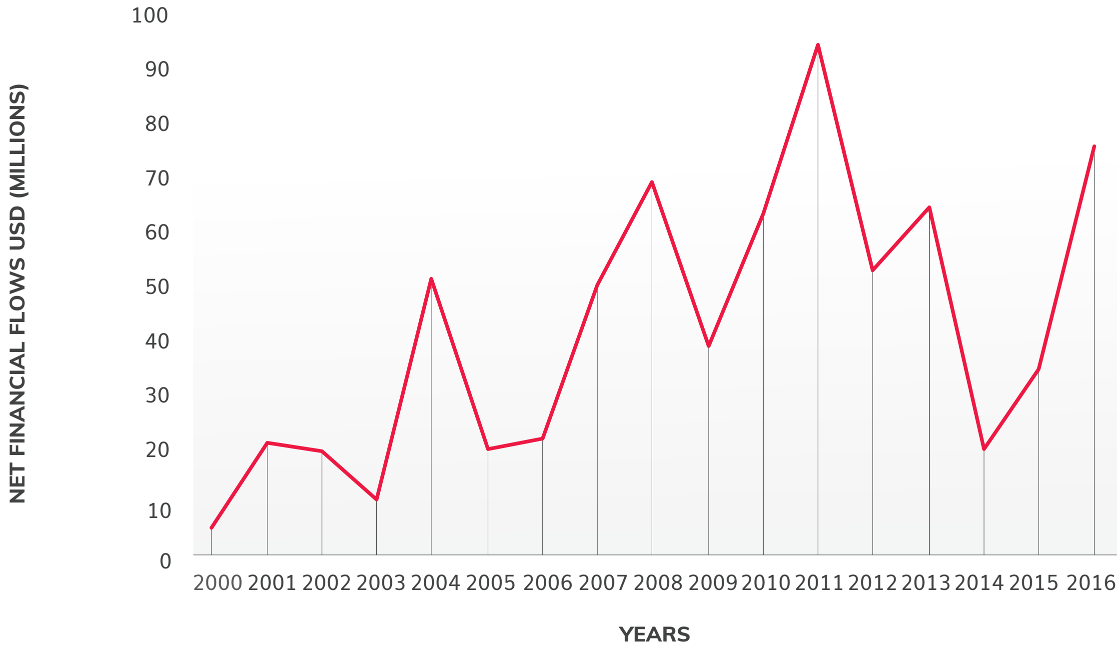
Senegal is experiencing a stable macroeconomic situation.

An overview of financial flows in Senegal and the role of blended finance in the development finance context

In the context of achieving the SDGs, it's important to understand how recipient countries like Senegal align its strategies and priorities with the fluctuating development finance landscape, especially in face of new financing instruments such as blended finance, other emerging modalities, and players.

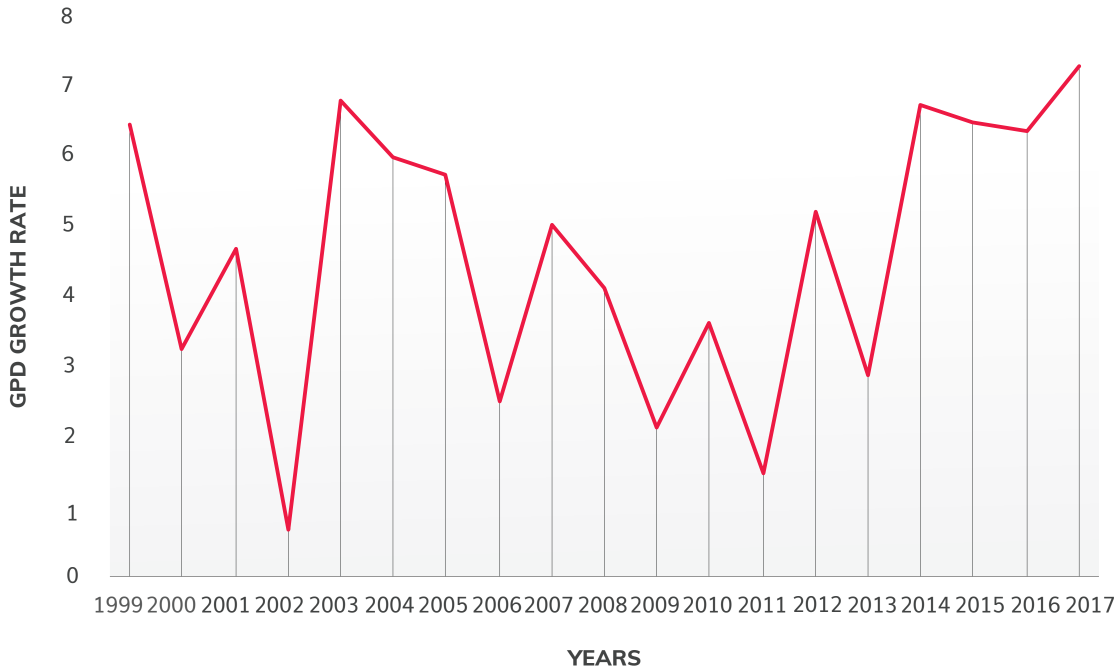
A brief literature review reveals that Senegal is experiencing a stable macroeconomic situation with growth expected to settle at 6,8% in 2017 and a relatively low inflation rate contained at 1,3% (IMF, 2017; World Bank, 2018a). Net financial flow was highly volatile between 1980 and 1990 and was low from 1990 to 2008 (World Bank, 2018b). However, from 2008 onwards net financial flow consisting of concessional loans has been increasing and it is projected to stabilise at its highest point until 2020 (See Figure 1).

Figure 1. Senegal, net financial flow, 2005-2016



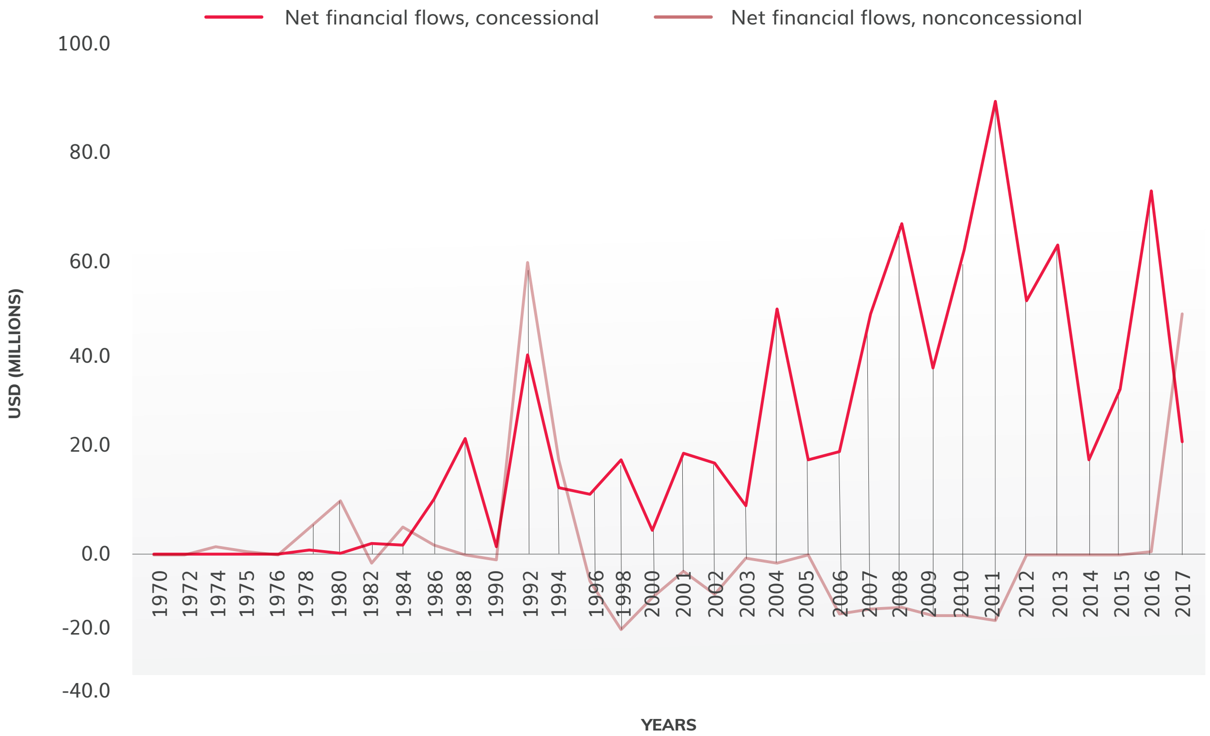
Source: World Bank (2019), elaborated by the author.

Figure 2. Senegal, growth rate, 1999-2017



Source: World Bank (2019); elaborated by the author.

Figure 3. Senegal, net financial flows 1970-2017



Source: World Bank (2019), elaborated by the author.

This section analyses the net financial flow profile of Senegal to shed light on its approach to development cooperation and development finance regarding the Plan for an Emergent Senegal (PSE), Senegal's new national development plan. In recent years, Senegal has experienced a significant increase in options in term of new and diverse sources of financing for development. However, due to Senegal's expansionary fiscal position, its choices and options regarding resource allocation in different sectors are less selective according to the OECD Development Assistance Committee (DAC) Secretary Report (2014). According to this report, the Senegalese government has a different approach to concessionality compared to its counterparts in the Economic Community of West African States (ECOWAS). Due to the inherent flexibility of the national strategies, the Senegalese government relies on budget support, Eurobonds, speed of delivery, and alignment to national strategies due their inherent flexibility.

According to the IMF benchmark for low-income countries on financial terms for debt resources, the Senegalese government criteria for concessional loans prefers a minimum grant element of 35% of the nominal value of the loan (OECD, 2014). One might argue that the large inflows of personal remittances (10% of GDP) which are currently well above ODA flows (7.4% GDP), might relax the financial terms for debt resources and budget constraints for Senegal (World Bank, 2018c). If this is true, the government and policymakers in Senegal must create a favourable atmosphere for attracting more remittances to leverage private capital for sustainable economic development.

Moreover, according to the IMF, Senegal remains at low risk of debt distress, even though its debt levels increase from year to year (IMF, 2016; IMF, 2017). Senegal relies on the regional market when it comes to non-concessional debt, which has raised the debt service burden on the budget (IMF, 2016). For instance, according to the IMF's sixth review of 2018, the country's return to the regional WAEMU bond market in 2019, would help rebalance the composition of government debt and contribute to the overall development of the market. Considering this background, attempts to develop a comprehensive debt management strategy should look more into concessional and semi-concessional loans to ensure a strong economic return to leverage private investment.

Context, policy and institutional frameworks

The most important development financial institutions in Senegal include the International Finance Corporation (IFC), the Sovereign Fund for Strategic Investment of Senegal (FONSIS), the Prioritary Investments Guarantee Fund (FONGIP), the Overseas Private Investment Corporation (OPIC), the United Kingdom Development Finance Institution (CDC-Group), the European Investment Bank (EIB), Proparco (a subsidiary of the AFD), the German Investment Corporation (DEG), the Netherlands Development Finance Company (FMO), the Investment Corporation of Dubai, the IsDB, among others. In Senegal, the AfDB is considered to be the major African DFI operating in the country.

> **Development Finance Institutions are known to have a positive impact in the country or sector where they invest.**

According to the World Bank, DFIs have been created by governments to promote economic and social development (2018, p. 38). They usually provide credit and a wide range of institutional capacity-building programs to households, SMEs, and larger private corporations that are sometimes excluded from commercial, local, and regional capital markets. As a result, DFIs focus on harnessing and channelling investment into strategic sectors of the economy, such as energy, health, infrastructure, agriculture, international trade, water and sanitation, green industries, among others.

Moreover, DFIs are known to have a positive impact in the country or sector where they invest. The concept of additionality captures the basic idea that multilateral development banks should contribute beyond the mechanisms available in the market and work in collaboration with the private sector. Generally speaking, DFIs additional value can appraise projects and programs by increasing four aspects of financial additionality: a) policy additionality[2], b) financial additionality[3], c) demonstrative effect of showing a competitive risk return profile both quantitatively and qualitatively[4] and, d) design additionality[5].

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2 if a particular policy interventions are evaluated to be causing the activity to take place in the sector.

3 When the market can't or does not offer the same opportunity or provide an added value that others can't.

4 For instance in competitive risk return profile the instrument provide strong development impact both quantitatively and qualitatively in demonstrating the viability of the investments or sectors and of attracting additional investement.

5 Policy or instrument that are solely design to emulate positive development impact.

In Senegal FONSIS and FONGIP provide multi-level financing preparatory studies required for technical structuring, financial, and legal set-up, as well as harmonisation of the institutional and legal framework on public private partnerships (PPP) with high development impacts.

The role of DFIs in blended finance deals

> **The use of blended finance in Senegal is slowly increasing.**

According to the Development Initiatives Report (Caio & Tew, 2016), Senegal has adopted blended finance mostly through FONSIS. In addition to FONSIS, Senegal's key international DFIs include the World Bank's IFC, the French Development Agency (AFD), the AfDB, and the European Investment Bank. This cooperation scenario shows the extent to which the Senegalese government is increasingly diversifying its options from a purely 'grant focus' to combining public and private sector funding to implement the SDGs. Senegal is considered among the low-income countries that receive the largest amounts of investment mobilised by blended finance.

The use of blended finance in Senegal is slowly increasing and the prospect for future growth is significant according to a representative of the Ministry of Investment Promotion and Partnerships of Senegal. In fact, the PPPs National Committee (CNAPPP) within this Ministry, is responsible for handling preliminary project assessments and appraisals, conducting institutional capacity building, and providing technical support throughout every project's lifecycle.

The European Investment Bank supports blended finance by providing better financing conditions for upstream technical assistance, national and regional studies, and targeted risk capital operations. The African Development Bank via the Sustainable Energy Fund for Africa operates under three financing frameworks: project preparation, equity investments, and business environment support. The Investment Corporation of Dubai supports the establishment of islamic finance windows[6] through the Islamic Financial Institutions Development Program to transform their operations from conventional to Islamic finance[7].

Between 1996 and 2006, the Ministry of Water and Sanitation in Senegal successfully closed a deal to fund a USD 500 million investment loan using blended finance. The players involved in this deal were multilateral and bilateral donors (80%), private players (13% through efficiency gains), the National Society of Exploitation of the Waters of Senegal (SONES) (3% equity), the government of Senegal (2% through fiscal transfers), and local commercial banks (2%).

In fact, according to the World Bank (2017a), commercial banks have already successfully financed two loans. For instance, in 1998 a USD 20 million loan from a risk pooling strategy of Senegalese commercial banks was used to diversify risk and increase confidence among the involved stakeholders (World Bank, 2017a). According to the World Bank (2017b), SONES ended up not using the entire loan received from Citibank because the project delivered much better investment than anticipated. This outcome gave local banks the confidence to renew the experience in 2000 to design, build, and finance the construction of a new water treatment plant (Keur Momar Sarr) in the northern part of Senegal. In this project, a local commercial bank (CBAO), provided a USD 7 million direct loan to SONES to provide subsided sewerage systems for the most vulnerable communities.

It is important to note that prior to this deal, a well performing institutional and contractual

6 An Islamic Window is a branch or department within a commercial bank, which follows the rules and regulations of the Shari'a Advisory Board to develop and offer Islamic financial products and solutions to its customers.

7 See the Toolbox G20 for instruments available to support private investment in African countries. Available in: https://www.compactwithafrica.org/content/compactwithafrica/home/documents.html

framework was already in place since 1996 and was key to the success of future deals and operations. Lessons from the use of blended finance in Senegal can be identified. A participant in this study indicated that before the blended finance intervention in the water and sanitation sector, the quality of water service delivery was extremely poor. However, after the intervention the sector has seen important improvements.

According to the head of FONSIS, a public-private partnership transaction on projects between the World Bank and UNICEF will leverage domestic-private finance for the delivery of water and sanitation services in rural areas of Senegal by 2020. It is important to note that even though information about these projects was provided by officials interviewed in this study, official information and data about past investments and institutional arrangements is still difficult to access in Senegal. As a matter of fact, lack of access to data prevents stakeholders and researchers from having an objective assessment concerning the social and economic impact of these projects. Moreover, these obstacles can also hamper the attractiveness of private finance in addressing the multiple barriers to promote the use of blended finance in Senegal.

How can blended finance attract private finance and address existing barriers in Senegal?

In an interview conducted for this study, the Vicepresident of the Power, Energy, Climate and Green Growth Department of the African Development Bank indicated that he only way to achieve the Sustainable Development Goals is to strategically use more public capital to unlock private investment. According to the Chief Executive Officer of FONSIS the private sector and its investors could use an "interlocutor" like FONSIS to bring private sector competencies, efficiencies, and capital to the public sector in Senegal.

For blended finance to attract private investment and enhance development in Sengal, several reforms are needed. Even though Senegal is at low risk of debt distress, the country's negative public balance sheets can negatively affect the country's credit rating profile. These issues need to be urgently addressed, specially as the demand of SDG-related projects rises in the country. According to government officials interviewed for this study, blended finance is a good option for the public sector to overcome the negative effect of fiscal deficit across sectors.

Another element that needs to be addressed is the risk-return profile of blended projects which are not competitive enough to challenge the rate in developed markets. For commercial banks, developing market returns are more attractive in terms of internal risk of return. As a result, in an environment of persistent low yield low return, almost all the representatives from commercial banks interviewed for this study expressed their aversion to invest in less 'familiar' transactions when real and perceived risk can generate abnormal returns.

Another critical element highlighted by the Chief Cabinet of the Ministry of Investment, Promotion and Partnerships and the Vice-president of the Power, Energy, Climate and Green Growth Department from the AfDB is the need to categorise deals by their operative objectives and their links to national processes, plans, and priorities. Interviewed officials, following Clark & Monk's ideas (2015), believe that in Senegal the categorisation of strategic development fund will help identify the contexts where wealth sovereign funds operate as wealth creators rather than wealth appreciators in capital scarce environments.

Figure 2 below illustrates this argument. The two axes illustrate the different positions in which strategic development funds operate and how to optimise their performance by adopting multiple strategies to maximise development and financial returns on a project basis (Clark & Monk, 2015). According to Clark and Monk (2015), strategic development funds in the upper left quadrant need to responsibly reorganise, restructure, and innovate state funds to foster commercialisation and higher returns on investment. If sovereign development funds are in the upper right corner of the quadrant, investing in emerging domestic industries will yield greater financial returns, especially when blended finance capital is dedicated to those industries or sectors. However, strategic development funds in the lower left quadrant are less linked to specific industries/sectors or national assets. Consequently, these funds need to diversify their portfolios to balance out those that are no longer profitable in the long run. Strategic development funds that are in the lower right quadrant, given their resources, can innovate and tailor their financial structure to the needs of the local economy.

According to officials of FONSIS, access to expertise and experiences from the private sector can improve service delivery. However, in most commercial banks (Orabank, CEBEAO) experience in adopting and implementing blended finance instruments is not well developed. A risk management officer in a commercial bank indicated: "When your careers is tie to your revenue performances, and you see your colleagues being constantly fired you are more and more averse to unfamiliar transactions." Moreover, according to interviewees, the private sector has not yet identified the instruments and reforms needed at the institutional level, or the financial arrangements that are necessary for the adoption of blended finance in the banking sector in Senegal. Another barrier is the lack of a regulatory environment and limited capacity building mechanisms to ensure that desirable skills sets are being developed in the private sector.

According to the head of the AfDB, policy instruments that could enhance the adoption of blended finance include the reduction of capital controls, acceleration of company registration procedures, creation of fiscal incentives, and removal of unnecessary barriers. According to the Ministry of Investment Promotion and Partnerships barriers that prevent the implementation of blended finance in Senegal are:

- Delays in the full implementation of regulatory frameworks relative to partnership contracts.
- Weak blended-type contracts signed by local governments that do not seem to have taken full advantage of the opportunities that blending represent for them.
- Lack of knowledge about the causes leading to confusions and delays.

- Lack of specific skills related to specific legal, technical and financial issues.
- Low level of project maturity causing numerous adjustments and contractual modifications that increase the cost of the projects.
- Lack of access to information concerning ongoing projects.

Existing rules and tools that currently govern aid, grants, and concessionality need to start targeting different risks, accountability issues, stable market-driven returns, and flexible partnerships. With these changes, development finance will work as an effective tool to solve global problems and eradicate poverty in developing countries.

Government engagement strategies with DFIs to mobilise private finance in Senegal

In Senegal, the government engages with DFIs through FONSIS. FONSIS has built an institution with significant financial and transactional experience and remarkable success since its creation in 2013. According to its Chief Executive Officer, FONSIS has a proven record and experience aligning with the private sector. As a result, the institution (FONSIS) is perceived as a financial intermediary when it comes to market credibility, access to various networks of international investors and expertise to initiate, manage, and strike deals.

In Senegal there is no public private partnership legal framework that govern the PPP project life cycle. Nevertheless, the government has put in place a PPP unit, that provides support and expertise to government ministries or public entities carrying out PPP projects (with public payment and/or PPP concessions). However, this does not mean that FONSIS is the main institution overseeing blended finance projects in Senegal.

In compliance with its mission, FONSIS intervenes at certain stages of the life cycle of a PPP. The institution main responsibilities include:

- Validation of preliminary studies
- Follow-up of key stages before the awarding procedure
- Review and validation of contracts
- Monitoring of project execution if necessary
- Guidance on procedural safeguards and required dissemination procedures

Do blended finance providers engage with host countries at the strategic level to ensure that priorities in their project portfolios align with national priorities?

One of the objectives of this study was to understand if the project portfolio of public and private institutions is aligned with Senegal's national priorities as defined by the country's development plan (PSE). Interviewed officials from the AfDB and from the Senegalese government argued that most of the existing projects in their institutions target development activities with high social impact.

> **In the private sector there are other factors related to risk return that can hamper the development impact at the initial phase of the negotiation.**

In the private sector there are other factors related to risk return that can hamper the consideration of development impact at the initial phase of the negotiation. Given that Senegal, has a national development plan in place (PSE) that covers 73% of the Sustainable Development Goals and targets, FONSIS argues that its priorities align perfectly with the national strategy of Senegal. In fact, among FONSIS priority sectors are agriculture, fishery, infrastructure, logistics, energy, social housing, mines, technology, education, health, business and, tourism. Interviews with key players from the government showed that in the case of Senegal, blended finance instruments are at the heart of PPP strategies in key development sectors. For instance, FONSIS has approved the financing of six projects included in the country's development plan for a total amount of USD 70,008,000. Other relevant sectors for blended finance are alternative energy, medical imaging, and SMEs.

Sectors supported by blended finance projects

Currently there are 15 projects using blended finance in the health, energy, and ICT sectors in Senegal. The financial closure of eight projects will end in less than three years. The total cost of these deals was financed through direct investment, co-investments and debt relief, with a multiplier effect from 15. According to FONSIS, a leverage ratio of 1/15 is the basis to determine how much capital comes from the private sector in the form of debt (loans), equity investments, or risk management products. According to FONSIS, most of the concessional instruments used are guarantees, technical assistance grants, currency hedging, and risk insurance.

The following sections provide with concrete examples on how blended finance instruments are currently being applied in Senegal in specific sectors with different project sizes, volume of resources , mobilisation ratios, and key players.

Health Sector

In the health sector in Senegal there are major projects being financed using blended finace instruments. For example, a modern medical imaging center was built by POLIMED (Medical Infrastructures Poles), FONSIS, and a public health establishment in Mbour with the support of the Ministry of Health and Social Action for the amount of USD 2,540.40. This project is perfectly aligned with national planning objectives and the SDGs. According to the Minister of Health, the centre serves the needs of vulnerable communities by allowing all Senegalese to benefit from medical care at a lower cost. According to FONSIS this project is a call to the public and the private sector to play their part and contribute with the development of Senegal.

Other projects carried out under a similar logic include "Parentus", the first industrial unit for massive solutes production in Senegal. It produces USD 11,323,000, of which USD 7,490,600 are mobilised from commercial banks such as CBAO[8] and BOAD. The cost of the installation of the industrial units (USD 4,355,000) was covered by the Priority Investment Guarantee Fund, the National Bank for Economic Development , the Sovereign Strategic Investment Fund, and the Ministries of Industry Mines, and Trade. The inauguration ceremony of the Parenterus took place on June 2016 in the Municipality of Diender (Thies region). The Parenterus project is a first step towards new opportunities for investors in the pharmaceutical industry in Senegal.

FONSIS is currently working on a project using public funds to leverage private capital from ORABANK[9] and other private banks to build medical infrastructure at the Mathlaboul Fawzani National Hospital of Touba (the second most populous city in the country with 753,315 inhabitants). The public fund will be fully financed by the state for an amount of nearly USD 12,194,000.

Energy Sector

Senegal is highly dependent on imported oil and faces high levels of deforestation and over-exploitation of natural resources. In the past 6 years the country has been experiencing multiple power shortages that had impeded the structural transformation of the economy. In order to address the energy challenge in Senegal, Proparco, a development financial institution partly owned by the French Development Agency and private shareholders from developed countries, provided 80% of the necessary funding in support of the largest solar power in West Africa. PROPARCO allocated a USD 39,554,250 loan with a 18-year maturity to finance the construction and operation of this photovoltaic power plant with a nominal capacity of 30 MWc. In this project, FONSIS manages the

8 CBAO is a subsidiary of Attijariwafa Bank, the first banking and financial group in the Maghreb.

9 ORAGROUP is a holding company of the African banking group ORABANK.

project, securitised assets including land and others, and handles the negotiations with the private sector.

FONSIS strong collateral, future cash flow, and high probability of success attracted Meridiam Investment Fund, the French manufacturer specialised in solar energy, Solardirect (Engie), and Schneider Electric to join the project. This project is currently being implemented in the northern part of Senegal.FONSIS and local private investors hold 45% of the project's equity.

Infrastructure sector

The Dakar-Diamniadio highway project was financed using blended finance (Table 1). The project was the result of publicly-backed concessional and non-concessional funds that were leveraged to attract private investment. Official development partners provided a total of USD 176 million, and the Government of Senegal supplemented with USD 54 million in public resources. The private sector contributed with USD 48 million of the total cost (USD 40 million through equity and USD8 million through debt.)

According to Samans (2016), If blended finance means leveraging large amounts of private funds using small amounts of publicly backed funding, the opposite seems to have occurred in Senegal. Large publicly backed resources have been leveraged by a small amount of private finance enabling a French civil engineering construction company (Eiffage S.A) to collect tolls from road users in Senegal. We interviewed the head of the AfDB in relation to this project and his analysis shed light on several issues.

First, it was pointed out that there is the need to understand the financial structure of most DFIs and how it affects blended finance schemes. For instance, in the case of the Dakar-Diamniadio toll highway complex, the African Development Bank had three categories of funding: African Bank (non-concessional), African Funds (concessional), Special Fund of Nigeria (Nigeria Trust Fund). In fact, Senegal could not be considered under any of these categories because it is transitioning from LDC to DC. Therefore, Senegal was classified as a blended country. Blended countries can thus benefit from non-concessional and concessional funds from the bank. In addition, since the borrower was a private entity, the AfDB allowed the Senegalese government to use concessional funding to mitigate the social impacts, loss of income and loss of property caused by the displacement of populations affected by the project.

Eiffage S.A., received a non-concessional loan from the AfDB, and the Senegalese government received a non-cessional loans with a grant element in it. The grant element is less or equal to 35% of the total amount. However, to secure a payment mechanism, the AfDB required Eiffage to open an ESCROW account (within a commercial bank) in order to reimburse the AfDB. From that point on, the AfDB took the lead and brought additional private entities on board like PROPARCO, and Bank of Africa which loaned Eiffage USD 10 million with a 13.5 tenor and fixed interest rate of about 10% of the total debt of the project. According to the Head of Office in Dakar who was involved in this project, these type of blended projects can open up access for blended countries to potentially larger pools of resources on tighter terms.

Upcoming projects and deals

Projects that are in the process of validation using blended finance instruments include:

a. Climate impact projects and a dedt fund for the financing of projects of renewable energy, efficiency energy, and solar off-grid.
b. Establishment of a rapid transit bus line on 18.3 km with 23 stations including 3 terminals from Cabral to Guédiawaye.
c. Scaling-up solar energy in Senegal and the establishment of a solar power plant with a capacity of 100 MW.
d. Transformation plant (organic waste into natural gas) to meet the energy needs of the Dakar abattoir.

e. Electrification of 200 villages installed by the Emergency Community Development Program.

In addition, the Sovereign Fund for Strategic Investments has just approved the financing of six projects included in the Senegalese Emerging Plan (PSE) for a total amount of USD 69,680,000 here USD 4 billion are from other private investors and commercial banks. In addition, targeted sectors include agriculture and industries, energy and mining, services (hotels, tourism, health, infrastructure), information and communication technology, small business enterprises, and real estate.

Focus on the domestic private sector

Concerns and limitations for the private sector

In Senegal, the private sector is starting to fully engage with the public sector. Interviewed stakeholders indicated that blended finance should ensure that financing doesn't crowd out the private sector. However, without a competitive and transparent market with an improved climate for business that supports private sector development, it would be difficult for the private sector not to be excluded. Moreover, there is a need for innovative financing models customised to the needs of the private sector in Senegal.

> **There is a need for innovative financing models customised to the needs of the private sector in Senegal.**

It is important to keep in mind that the optimal balance for public and private funding is unlikely to be the same for all types of projects, sectors and countries. The balance between blended projects and the design of instruments in every sector needs to be determined at the sector level to enable a functioning market. In the case of Senegal, if the government fails to enable the necessary environment, the provision of blended finance's relative cost will increase. This will definitely affect the cost of private capital and the optimal mix of debt and equity in the different sectors of the economy. A representative from a commercial bank argued that "the government of Senegal must enable networks and infrastructure to facilitate planning and uptake of blended finance, especially if blended concessional finance for private sector projects involve a raft of complex rules and regulations."

Additionality

At the moment, there is no ex-ante assessment done on potential development additionality in projects expected to have SDG-related impact. There is no evidence in relation to monitoring and evaluation mechanisms, or data on blended finance projects related to the SDGs. There are however, some legal instruments in place that call for project evaluations. Act 2001-01 (2001) is the main environmental management instrument in Senegal and establishes that: "Any development project or activity likely to undermine the environment, as well as all policies, plans, programs, regional and sectoral studies have to be subjected to an environmental evaluation" (AfDB, 2014).

Projects such as the Dakar Diamniadio Turnpike project, which comprises a highway that starts East of the Diamniadio interchange and is at its second phase, provides insights on the existence of ex-ante assessments following national, environmental, and social evaluation procedures. In addition, the Dakar Diamniadio Turnpike project does integrate the needs and concerns of both the bottom section and upper section of the economy.

The main objectives of the project are:

- To ensure rapid movement of goods and people.

- To end traffic congestions that harm to the national economy.
- To upgrade road infrastructures to meet the needs of sustainable development and strengthen the road network of the Dakar Region.
- To link Dakar to important development centers such as the new economic zone of Diamniadio, Le Nouvel, Blaise Diagne International Airport, the tourist center of Saly Portudal, as well as the inner part of the country.
- To promote urban and rural development policy outside the saturated peninsula of Cape Verde and thus, meet the needs of a balanced territory for a better distribution of wealth.
- To participate in economic integration at the sub-regional level through the Dakar-Bamako, Dakar-Banjul-Bissau and Dakar Conakry corridors.

Despite progress, a well structured system of monitoring and evaluation (including ex-ante evaluation, monitoring, mid-term evaluation, terminal evaluation, and ex-post evaluation) is not yet well implemented in Senegal. While the depth and focus of evaluation is different for each project, a centralised and standardised process would allow verification and follow-up of performance, impact, implementation, and project relevance in face of the SDGs.

Domestic absorption

Domestic capacity to absorb resources mobilised through blended deals is still weak in Senegal. To address this challenge the government of Senegal needs to make consistent efforts to attract and prepare pipelines of investable projects targeting SDGs. The Senegalese Strategic Investment Fund (FONSIS) has taken strong steps towards its alignment with the private sector by openly sharing its investment criteria and conditions. This indicates that institutions are increasingly aware of the role of transparency and accountability in attracting partners from the private sector with commercial interests. One of the challenges for FONSIS is to keep institutions from being influenced by politics while continuously having to collaborate with government entities.

In relation to absorption capacity at the national level, there is much more room for improvement and involvement of the private sector. According to interviewed government officials, in order to address this challenge, the government is committed to decentralise projects and programs through the Emergency Community Development Program and involve local government entities, thereby ensuring improved absorption of blended capital.

Actors alongside the value chain also call for more cooperation and engagement of major donor agencies and philanthropic organisations, which are often missing players in Senegal. According to the interviewees, the strategic use of blended finance can facilitate uptake and leverage of more private funds going into sectors of high social and economic impact. They also argue that donors' engagement and cooperation would not lead to substantial rises in real interest rate. This means that donor cooperation and endorsement can help mitigate risk and raise the profile of projects and programs in Senegal and foster risk pooling programs and promote blended finance. However, commercial banks still prefer classical lending instruments on a short-term basis (0-5 years) instead of investment choices with long term risk management strategies.

Development impact and domestic policy

Overcoming barriers for investment

In Senegal, no project has been executed under a unified legal framework guiding PPPs since 2014. According to a representative of the AfDB, one of the major barriers for blended financing in Senegal is the absence of a legal framework that can address the possible challenges and difficulties that arise from the adoption of blended finance. This statement is echoed by the private actors interviewed for this study. The Risks and Operations Manager of BSIC Bank indicates: "When the risk includes not only financial but legal aspects, you could be exposed to complex loss on your investments."

As noted by development banking representatives: "The critical barrier towards achieving an uplift in infrastructure investment in emerging and developing economies is not a lack of available finance but an insufficient pipeline of bankable projects ready to be implemented." Banking representatives suggest that an appropriate alignment between national priorities and commercial financing is necessary in the earliest steps of the process. This will allow for agency resources to be deployed effectively and projects suitable for commercial funding to be prioritised and fast-tracked. This will sort out risk-return profiles of projects that are not competitive.

The Senegalese government must make a commitment to strengthen partnerships with the private sector (commercial banks, private equity funds), and build flexible institutional capacity, strengthen policies and regulatory frameworks, as well as transparency and accountability guidelines.

Transparency and accountability

Another major challenge in Senegal is linked to fiscal discipline, budget transparency and coverage, and budget cycle management. A legal framework harmonising public finance management should be the cornerstone of development finance in Senegal. Existing inadequacies are an obstacle to unleash the potential of development finance. Moreover, this hinders sub-regional economic integration, and effective and efficient public service delivery.

There is not enough information available on the processes in place for the selection of private sector participants in blended projects. At the moment this research was conducted it was not possible to get information on this topic. The committee responsible for preliminary project assessment, capacity building and technical support for contracting authorities through the project lifecycle in Senegal highlights the need to segment the value-chain finance analysis (preparing, pioneering, facilitating, anchoring, transitioning)[10]. Incentives and capacities of actors to deliver or facilitate financial access within the value chain are also key. In each phase, players need to be involved in the explorative phase to build strong projects and grow their investments together.

Another element brought up during interviews with private commercial banks is the challenge to scale up blended finance deals across the financial sectors due to tight regulations in the new framework of Basel II and Basel III rules[11]. Can the private sector (banks, private equities fund, and insurances) foster the preservation of a resilient and robust banking system while contributing towards the accomplishment of the needs of the least developed economies.

Key players like the Head Office of the main Sovereign Funds Strategic Investment (FONSIS), the Office of Investment Promotion in Senegal, private commercial banks and private equity funds reveal that the use of blended finance is not only leveraging private finance funding in Senegal but also addressing the non-financial benefits of blended finance such as market failures, risk exposure, the viability of innovative structures, and the access to specialised knowledge from partners.

Demonstration effect

Given that projects that use blended finance instruments are not well-known in the private sector, the effects of most of these projects are still to be seen. Moreover, building on success stories, demonstration effects from the health and energy sector should be managed very well not to discourage the private sector from building better functioning markets than can result in larger volumes of private capital for development.

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10 The preparation of the early stages of a project is currently handled by FONSIS. Facilitating the participation of private entities at this stage would be a way forward.

11 Basel II is the international framework in assessing of international banks' capital adequacy, enacted in 2004. Basel III enacted in December 2010 sets the regulatory framework targeting governance and risk management as well as two global liquidity standards.

According to interviewees, blended finance is gaining momentum in Senegal and if there were know projects or deals that did not succeed for some reason, the demonstration effect would be negative with significant rippled effects. In turn this will discourage private investors from further inquiring and showing greater interest in participating in sectors like health, agriculture, infrastructure and energy. As a result, greater institutional support or enabling environment, or better assessment of risk in the project life cycle is required to foster growth and the expansion of blended finance instruments in Senegal.

Conclusions

Blended finance is gaining momentum in Senegal. Majors stakeholders reveal that the use of blended finance is not only leveraging private finance funding in Senegal but it is also addressing market failures, risk exposure, viability of innovative structures, and access to specialised knowledge. Nevertheless, there is still the need to bring private commercial banks on board given that most initiatives and transactions that take place in different sectors of the economy do not yet include the active participation of commercials banks.

The study identified the need to conduct segment value-chain finance analysis (preparing, pioneering, facilitating, anchoring, transitioning), and involve the private sector at the very beginning of the project life cycle. Few private banks are currently involved in most of the transactions and have the domestic capacity to absorb resources mobilised through blended deals. Another challenge identified in Senegal has to do with the ambiguity or total absence of legal frameworks. Further research and further access to data and information are needed to assess the impact of blended finance projects in Senegal.

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Appendix 1

Key actors interviewed during this study

International organisations and Governments (organisations and divisions)

- International Finance Corporation (IFC)
- Islamic Development Bank (IsDB)
- International Finance Corporation (IFC)
- European Development Fund (EDF)
- French Development Agency (AFD)
- African Development Bank (AfDB)
- Banque Arabe pour le Développement Economique en Afrique (BADEA)
- National Economic Development Bank (former FPE)
- Proparco
- Netherlands Development Finance Company (FMO)
- Banque Ouest Africaine de Développement (BOAD)
- Priority Investments Guarantee Fund (FONGIP)
- Sovereign Fund for Strategic Investment (FONSIS)
- Ministry of Finance
- Ministere de la Promotion des Investissements, des Partenariats et du Development des Teleservices de l'etat
- National Agency for the Promotion of Investments and Large-scale Infrastructure Project (APIX)

Commercial banks

- Terranga Capital Dakar
- ECOBANK

- Attijariwafa Bank
- Bank of Africa Sénégal
- Citi Senegal
- Microcred
- International Commercial Bank
- Banque Atlantique Sénégal
- Banque Régionale de Solidarité
- Banque de l'Habitat du Sénégal
- Société Générale de Banques au Sénégal (SG-BS)
- Banque Sénégalo-Tunisienne
- Crédit Lyonnais Sénégal
- Caisse Nationale de Crédit Agricole du Sénégal (CNCAS)
- Compagnie Bancaire de l'Afrique Occidentale
- Banque des Institutions Mutualistes d'Afrique de l'Ouest
- Banque Sahélo-Saharienne pour l'Investissement et le Commerce (BSIC)
- Banque Internationale pour le Commerce et l'Industrie du Sénégal (BICIS)
- United Bank for Africa
- Banque Régionale des Marchés

Private Equity Funds

- AFIG FUNDS
- PROPARCO
- ECP Private Equity Funds
- BRIGHTMORE

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