Development loans and guarantees

Sida

New finance instruments at Sida

Sweden has launched a new instrument for untied and flexible financing – Development Loans and Guarantees. This will contribute to reducing poverty in developing countries that are in need of investments in areas such as infrastructure, environment and climate. This is also good news for the development of local financial markets.

The enormous investment needs in developing countries cannot be solved by grants alone. Development Loans and Guarantees provide new opportunities to expand and leverage available resources for economic development by linking grant aid with market finance. Investments will be more competitive. With the new guarantee instrument, financial risks in investments can be lowered in a number of ways. Local currency risk as well as traditional risk coverage is possible. The instrument also allows for utilizing partner countries' own capital markets. Tapping in to unutilized local resources will enhance, strengthen and develop local financial markets to better meet local needs.

In this way, many countries will be able to reduce their aid dependency and instead be able to domestically finance economically viable investments. At the same time Swedish aid will be able to leverage the impact of its own investments substantially. Development Loans and Guarantees also serve as important instruments for positive development in times of financial uncertainty, when investments in general are falling worldwide.

A flexible system

The new Development Loans and Guarantees, launched in June 2009, are untied and more flexible than previous systems. The Development Loan can be described as a two component arrangement where Sida contributes a grant and the Partner will need to arrange for a loan on commercial terms. To ensure best results the loans and guarantee instruments can be used together or separately.

A special focus on climate and environment

The Swedish government has formulated a special Strategy on Environmental Loans and Guarantees, which allows both the use of loans and guarantees. The strategy may be applied also for countries outside Sweden´s so called focus countries. An earmarked budget exists for Environmental Loans. But the guarantees have the potential to unleash billions of SEK in areas where the private sector would otherwise be unwilling to shoulder the full risk in investments. Environmental Loans and Guarantees are primarily aimed at improving energy efficiency and renewable energy; management of waste, water and sewage; and transportation.

Access to electricity promotes economic growth through SHS.

Loans and cooperation
More poverty reduction for less

Access to electricity is one prerequisite for development. With limited resources it is important to make a distinction between commercially viable projects and project which are not, but promotes long term development. *Mozambique* and Sida´s joint investment in electricity generation capacity is an example of such a project. Sida supports a hydropower project of SEK 420 million through a grant of SEK 260 million, to be combined with a market financed loan of the remaining SEK 160 million.

By defining the share of the project which is commercially viable and adapting the financing model accordingly, project finance is more effectively and efficiently used. Use of available ODA resources are maximized and commercial finance utilized to finance investment components which are capable of generating income to cover their own costs, which in turn stimulates development of a more efficient local financial market.

In *Bangladesh* Sida has supported increased access to electricity for poor rural households by supporting the deployment of solar home systems (SHS). In this case, Sida, supported by the Global Program for Output Based Aid (GPOBA), co-finances the project together with local microfinance institutions. Sida's contribution is a grant amounting to SEK 65 million. With Sida´s grant, costs per unit and risk will drop to a level which both enables the microfinance institutions to lend to the poorer households as well as for the households to afford the investment. Total cost for the investment is estimated to be lower than cost for traditional fuels had been for the individual household. Through the scheme the SHS component will extend clean and reliable electricity access to over 100,000 poor households. With traditional grant financing less than 15 000 families would have been reached. To ensure quality and results, disbursement of the grant to the microfinance institutions will only be made after the solar panels have been installed.

In *Bosnia Herzegovina*, Sida and USAID have engaged in private sector development with a focus on agro business, and small and medium size business. There are many hurdles in the country, including accesses to finance. USAID and Sida have in cooperation with two local banks issued 50 % partial risk guarantees in favour of companies who need capital to grow. The guarantee, amounting to USD 20 million, of which Sida guarantees half, is a cost efficient way to support the banking sector to offer more loans to the target companies.

Team Loans and Guarantees closely cooperate with several key partners; AsDB, EBRD, GPOBA (WB), IFC, and USAID. Teaming up with partners are efficient ways to share risk, pipelines and know how.

Through Development Loans and Guarantees – and broad cooperation with players including banks, private companies, institutions and authorities – the costs for ODA can be reduced and total available resources substantially leveraged and increased.

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