Evaluation of Blending

Final Report

Executive Summary

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The evaluation's purpose, scope and background

This evaluation of blending as an EU aid delivery mechanism aims to:

- provide an overall and independent assessment of blending.
- identify key lessons and recommendations to improve and inform future choices on blending.

The scope includes EuropeAid support through seven investment facilities over the period 2007-2014: EU-Africa Infrastructure Trust Fund (ITF); Neighbourhood Investment Facility (NIF); Latin American Investment Facility (LAIF); Caribbean Investment Facility (CIF); Investment Facility for Central Asia (IFCA; Asian Investment Facility (AIF) and, Investment Facility for the Pacific (IFP). Geographically the scope is the regions covered by the seven facilities.

Total EU funding allocated to the investment facilities during 2007-2014 reached more than 2 billion Euros, representing 4% of DEVCO's funding. The amount effectively contracted (at 31/12/2014) reached 1.7 billion Euros and covered just over 200 projects in 46 countries.

Methodology

The evaluation is based on the methodological guidelines developed by the DG DEVCO Evaluation Unit. It was conducted in four main phases - inception, desk, field, and synthesis. The evaluation was managed by the Evaluation Unit, incorporating all relevant EU services in a reference group that was responsible to oversee the process. Nine evaluation questions (EQs) were formulated following a structured process based on analysis of EU policy framework and reconstruction of EU intended intervention logic related to blending. An inventory of EU support for blending was prepared and evaluation questions, judgement criteria and indicators were defined to guide data collection and analysis. The evaluation questions were clustered in 3 pillars: strategic relevance, value added and results.

A relatively wide desk sample of 46 projects was selected. Field visits were made to 12 countries and 32 projects were visited (of which 26 were in the desk sample). The evaluation used a combination of tools and techniques for primary and secondary data collection, including an online-survey to 38 EU delegations, analysis of regional and country strategy papers, literature review, meta-analysis of evaluations/audits, interviews with stakeholders. The stakeholders consulted included: beneficiaries and users of the facilities implemented, national partners, EU delegations, IFIs, the EC and civil society organisations. The evaluation was implemented between January 2015 and July 2016.

Conclusions

Strategic relevance:

Conclusion #1 Blending allowed the EU to engage more broadly and with strategic advantage - particularly in support of large infrastructure projects and for cooperating with countries in transition to medium income status.

Blending enabled the EU to engage in countries (lower medium and medium income countries), sectors (infrastructure) and projects (with specific policy challenges) which would have been mostly out of reach with grants alone.

Over 80% of blending during the period served lower medium or medium income countries (for projects taking place in a single country). The countries supported were characterised in some cases, by not being in eligible for grants and in others, as only being eligible to take highly concessional loans - due to the International Monetary Fund (IMF) debt sustainability framework.

Over 75% of blending operations were in capital-intensive infrastructure sectors (energy, transport and water & sanitation) which, by sheer project size, would be largely out of reach of development support were they to be funded by grants alone.
In more than half of the cases examined, blending addressed special project-level challenges that required grants and led to improved development impact. The special challenges arose from weakness in market mechanisms and, in some case also from the inability of the state to provide public goods. These challenges tended to block action by private and public sector actors to carry out projects that were otherwise economically feasible and in their interests. The challenges were also related to deficiencies in the information environment, in the perception of risk and, in the capacity and knowhow of the private and public sector (including failure in technology diffusion).

Often, the special challenges responded to by blending were associated with overcoming the presence of vested interests, severe regional disparities, and gross inequalities that distorted and complicated decision-making in a way that blocked action on important projects.

Blending also addressed the case of countries that for a variety of reasons did not have the fiscal space to take on the full borrowing cost of an unconcessional loan – even if that loan would have allowed them to benefit from positive externalities and finance highly economically feasible projects that were not financially feasible. Neither did they have the fiscal space to contribute fully to financing global public goods such as climate change and biodiversity. Just over half of the projects sampled (24 of 46) were under the debt sustainability framework of the IMF whereby counties can only borrow under highly concessionary terms, making grants necessary if the project is to go ahead. Many of the other countries in practice adopted the debt sustainability rules even if not obligatory.

The evaluation found among the sample of blending projects cases where the use of the grant:

- Improved the information environment so that private sector actors could make the right decisions (information).
- Changed the perception of risk so that investors were encouraged to invest in productive investments (risk).
- Introduced and developed capacity to make use of new technology (capacity).
- Covered part of the political cost of difficult reforms (reforms).
- Enabled market forces to reach marginalised population groups (social disparities).
- Ensured that economically feasible projects with high environmental and social benefits go ahead even if financially not feasible (positive externalities).
- Provided and encouraged contribution to global public goods such as mitigation of greenhouse gas emissions (global public goods).

Blending, through its leverage of loans, was associated with around 20 times more development funding principally key development finance partners but also to a lesser scale private sector investors. Project by project analysis shows that blending grants have either caused other funds to be mobilised (such as private sector investors in the EFSE project), and/or enabled previously earmarked funds to be formally approved and committed (e.g. for the Lake Turkana Wind Power project), and/or redirected funding to policy-compliant objectives (such as for the Seychelles Internet Connector project where grants were used to widen access to the internet). Whilst leverage does not apply causality where there is a “special challenge” as there is for most cases, there is also a strong argument without the grant the project would either: i) not have gone ahead or ii) would have had to find another source of grant subsidy to avoid being severely limited in its impact. In these cases blending engaged in projects that could not have been undertaken purely through loans and as mentioned earlier, the volume and size of the projects would, if funded by pure grants, have consumed a disproportionate amount of the available EU funding.

Blending offered the EU opportunities to increase its potential sphere of influence on the global development stage because blending has had a causal role in mobilising additional project finance in half the cases examined in-depth and by virtue of mechanically providing the EU – through the investment leverage ratio - a potential ‘seat at the table’ of lead donors, which is a way for the EU to further its policies effectively and steer other development projects. The team could not gather evidence on the extent to which the EU has actually made use of this potential for increasing its ‘sphere of influence’, mainly because this matter - which would merit a report of its own - falls outside the scope of this study.

Conclusion #2 The blending instrument, particularly for projects approved in the earlier phases, did not reach its full strategic
potential and did not address as fully as it could have the development challenges of lower income countries - for a variety of reasons

Some 72% of blending resources have benefitted lower medium (56%) and medium income (16%) countries – although this is highly influenced by the historical dominance of the Neighbourhood Investment Facility. During the same period the overall EU support to lower medium and medium income countries was 69% responding to the challenges of ensuring that countries that have recently attained lower medium income status do not slip back. The number of lower income countries has halved from 58 to 28 from 2000 to 2014. It should also be noted that large income disparities exist within lower medium and medium countries meaning that activities in these countries can still target the poor. It is also relevant to note that blending by only engaging with countries that have the fiscal space to take additional loans rightly tends to focus on the less poor countries. Nevertheless, 26% of blending focussed on low income countries. And, some 9 projects in fragile states have also been carried out. Two projects visited during the field missions indicate the potential that has been realised for poverty alleviation in low income countries (one involving water supply and sanitation in Uganda and another involving access to electricity the Atlantic province of Benin). These and other projects indicate that blending has a potential and capability to address the challenges of low income countries. But it is also apparent that without some changes in the historical practice of identifying projects, blending will find it difficult to respond to a greater prioritisation on supporting the development needs of lower income countries.

The additionality of the blending grant i.e. the focus on resolving specific challenges that could not be solved by a loan alone was not systematically emphasised in the earlier years under evaluation. Pro-poor objectives were not emphasised in the development of the project pipeline. Blending projects were not as closely aligned with national policies and priorities as they could have been. The blending guidelines which address these issues were developed late - some 7–8 years after the first blending operations were launched and it was only recently that the application forms were explicit in their demands for justification for the grant.

Too few IFIs were involved from an earlier stage. While there was an understandable need at the outset to concentrate on ‘making blending work’ with a few partners, over 90% of blending is still done with four major partners (EIB, KfW, AFD, and EBRD).

The positive findings on blending could lead to the question: how much of EuropeAid’s support should be blended? (it was about 4% for the 2007-2013 development cycle, and may reach 8-10% in the current 2014-2020 development cycle). Whilst this evaluation can contribute to addressing this question it cannot entirely resolve it – a resolution goes beyond this evaluation, as it needs detailed policy analysis, requires insights into the effectiveness and relevance of other instruments like budget support, the actions of other donors, it is also a country specific issue and, ultimately requires a policy level decision. What can be said at this stage is that there will be a set of countries (lower medium and medium income countries), sectors (especially but not exclusively infrastructure) and projects (those with specialised challenges) where blending potentially has a comparative advantage over pure grants and in many cases would also be the most effective support instrument. There are also prospects, which would require a change in current practice, to direct more blending support to lower income countries and target more clearly the poor (both in low income and lower medium countries). The proportion that blending makes of total EuropeAid then depends principally on the EU policy priority on those countries, sectors and projects and on the degree to which blending can succeed in sharpening its pro-poor dimension and therefore also relevance to lower income countries.

Value added

Conclusion #3 Blending has, in many instances, added significant value to the EU’s grant based development cooperation and also brought added value to IFI loan operations.

Where value has been added it has related to: leveraging policy reforms, creating high quality projects, unlocking available finance for improving access to finance and improving coordination to EU development cooperation.

Some blending projects contributed – mostly through technical assistance grants - to the
advancement of the national policy reform agendas that were also more widely supported by the EU and other partners such as the World Bank. There are examples of blending constructively supporting policy reforms particularly in the energy, transport and water and sanitation sectors across geographic regions.

Blending projects, often by directly using the grant made available, have led to robust and well-functioning projects that have been prepared with rigour - for example on ensuring high quality environmental impact studies. There have been long delays, which is not unexpected given the scale and complexity of the projects. But in most cases the projects, through close monitoring, often supported by grants for project management units and other support structures, have delivered to specification and avoided excessive cost overruns. Operation and maintenance has been taken seriously and plans and procedures were drawn up to varying degrees by all the projects sampled.

Blending also added value in widening the access to loan finance and reducing the financial barriers for micro, small and medium size enterprises. Close to 8% of the blending funds (Euro 130 million out of a contracted value of Euro 1.7 billion) were aimed at improving access to finance.

Blending led to strengthened donor coordination especially in the recent years where there was a greater involvement of the EU delegations.

Blending has mobilised the skills and experience of the IFIs and through its scale also served to deepen and enhance these skills within the IFIs. Without the blending operations carried out through the IFIs, the EU would not have been able, at least with its current staffing arrangements, to engage to the same extent in complex and large scale infrastructure and access to finance operations. The banking, risks management and project supervision skills of the IFIs have added value to the EU development cooperation. And, the development insights of the EU have added value to the operations of the IFIs.

**Conclusion #4** Blending grants have played a role in supporting private sector development mainly within the finance sector:

By financing C shares, blending grants have contributed to the mobilisation of private sector financial resources for projects with a development effect. By providing partial credit guarantees funded by blending grants, there is evidence that banks have expanded the sector breadth of their lending portfolios to include for example agriculture which was previously considered too high risk. There is evidence that some new borrowers, previously unbanked, have been drawn into formal finance, but there is also contrary evidence that these special lending schemes supported by blending grants have mainly financed small enterprises which already had bank loans.

The full potential of blending to mobilise the private sector within industry, energy, agriculture and other areas is not yet reached. New instruments under development such as ElectriFI and AgriFI have the potential to extend the reach of blending approaches and lead to longer term private sector development.

There is an impression that micro-finance institutions may be best placed to reach new, hitherto unbanked, borrowers because they can assess smaller riskier customers, but this does not imply that banks with specialised risk management capabilities adapted to SMEs could not achieve the same. It should be noted that the European Commission has an extensive portfolio of development cooperation projects with micro-finance institutions outside of the blending facilities.

**Conclusion #5** The lead IFIs approved by the EU have internal procedures that are a major element in ensuring the high quality of blending projects; the closely scrutinised process of project by project approval by the EU and the provision of grant funds for technical assistance support the development of high quality projects especially where the risks are higher.

The procedures of the IFIs are thoroughly assessed by the Commission prior to authorize an IFI to act as Lead. Through the preselection of IFIs and the closely scrutinised process by project approval, the Commission only contributes to the financing of projects with high quality standards. These projects are prepared by IFIs based on their internal procedures and due diligence and in accordance with the division of labour agreed with blending partners.
However, although blending grants were often used to enhance and ensure good quality, the adherence to international norms and best practice was ultimately the responsibility of the IFIs. The EU contributed through prudent selection of suitable IFIs to act as lead and by supporting the adoption of high standards.

Technical assistance grants for blending projects have been used to ensure: project design that was well-conceived and robust; implementation that was closely supervised and, attention to operation and maintenance. These grant funds provided through blending have allowed the IFIs to respond to a wider set of project opportunities, including those where the risk level of projects of an insufficient quality would have been too high without substantial grant funding.

Similarly, although coordination and transactions costs have significantly improved, compared to the days of parallel financing (where each IFI and donor would independently finance a specific element of a project) it could be argued that this is more a result of the Mutual Reliance Initiative (MRI) which although associated with the EU (and developed in response to the early challenges of blending and non-blending projects) is not unique to or dependent on blending. Blending however, takes full advantage of the MRI and the MRI approach is compulsory for blending operations.

Conclusion #6 There are also cases, particularly for the older projects, where the value added was less than the potential

It should be noted in the context of the contribution of blending to policy change, that the main objective of many of the blending projects was not to bring about policy changes but to provide much needed infrastructure. Nevertheless, the scale and national importance of blending projects, often in sectors that are dysfunctional but undergoing partially implemented reforms, creates an important opportunity for developing institutional capacity and bringing in much needed changes in policy and practice. In many cases blending projects have responded to these opportunities as evidenced elsewhere in this evaluation. However, there are also a significant number of cases where influence on policy reforms and institutional capacity has been disappointing. An example is the Pont Noire port in Congo Brazzaville where the otherwise largely successful investments in the new port did not address the wider policy related issues of longer term sustainability of the infrastructure and did not take into account the role of the port as part of an overall transportation masterplan.

A very few examples (outside the formal sample) were found where early blending projects pushed ahead with projects that ran counter to the policy reform efforts of the EU delegations, especially as concerns the establishment of cost recovery systems.

There have been some cases where the lines of credit being offered to increase access to finance did not have the intended effect as the country was over-liquid and needed credit enhancement rather than additional lines of credit. In other cases, there were examples such as in Moldova, where the credit reached existing rather than new customers and did not add value in the sense of widening access to finance.

In the opinion of partners and project implementers the transaction costs of some blending projects were high due to the use of procurement and other rules that were unfamiliar and sometimes incompatible with national procedures. Blending by involving multiple financing partners sometimes introduced additional complications and conditions despite the otherwise helpful effect of the mutual reliance initiative.

Whilst it is true that there was compliance with visibility rules and criteria, recognition of the EU role was still weak for most projects – as a result, there was a potential loss of political capital.

Conclusion #7 A body of good practice on adding value has been developed and has led to lessons learned that form a basis for continual improvement.

Good practices that positively influenced policy leverage included:

- Linking blending projects with wider reform packages, EU focal sectors, budget support (e.g. in Egypt and Morocco) and relevant EU partnership/ association agreements (e.g. Georgia and Armenia).
- Mobilising the knowledge and insight of IFI country offices with a long track record of focussed support to specific sectors.
- Implementing capacity development strategies that optimised the impact of
technical assistance on future institutional performance.

- Incorporating a transition or policy related objective into the core objective, rationale and design of the project - such as was the case for the later EBRD projects.

**Results**

**Conclusion #8** To a large extent blending projects, have been successful and have already achieved or are likely to achieve the intended results and there is evidence that the project outputs are being used and appreciated by the beneficiaries.

The majority of completed and close to completed projects have achieved (or are likely to achieve) their intended results – albeit often with long delays.

In common with most complex projects operating in the challenging environments typically found in many developing and transition countries, the main factors that positively affected project implementation were related to: the soundness of project design, the quality of project monitoring and, the professionalism of partners and contractors. The main factors that negatively influenced project implementation were: the lengthiness of reform processes, administrative bottlenecks and political instability at country level.

A feature that stood out for blending projects was that the IFIs had adequate systems, approaches and procedures in place to put blending projects back on track when they were delayed or subject to unforeseen changes.

The supervision and the monitoring of physical and financial project progress by the IFIs or their agents has been thorough. However, the degree to which socio economic, transition and development impacts (as opposed to physical progress) were monitored varied and was often a weak point of the blending projects.

There are also a few cases where projects did not succeed and did not contribute as planned to economic development or poverty alleviation because they did not reach their intended results. Examples include the Caprivi connector project and the Beira corridor project in Southern Africa.

There is little information available on job creation. Only five out of twenty-one projects reviewed actually aimed to impact positively on the creation of jobs and new businesses, and only three of them set quantitative targets to be reached in terms of temporary and/or permanent job creation. Available information points mainly to direct employment during the construction period. Nevertheless, a literature review indicates that the type of investments supported by blending, mostly large infrastructure projects in energy/transport/water in low-middle income or low income countries, have a positive effect on employment level.

**Conclusion #9** Project design was sound overall and as a consequence most of the projects that are still incomplete are likely to lead to their intended impact, however the internal project logic particularly for earlier projects was weak and the potential for poverty alleviation not optimised.

The logical framework used for planning activities was generally not sufficiently complete and was sometimes unrealistic. Whilst the logic of the results chain was overall well-conceived, the full transmission chain from activities until results was most of the time not sufficiently spelt out and articulated in the design documentation.

In many cases the nature of the blending projects and the comparative advantage of blending meant that blending projects aimed at macro-economic development rather than direct poverty alleviation. Large scale infrastructure aiming at improving the macro scale economic development can be an important and also essential contribution to poverty alleviation – but the linkages are not automatic and the targeting and selection of the projects and the consideration of alternatives to better serve the poor need to be informed and justified by more in-depth analysis than was usually available.

However, even bearing this in mind the comparative advantages of blending, there were missed opportunities to better and more directly target the poor (there are examples of projects across all sectors that were successful in this regard e.g. Kampala water and Sanitation, Uganda and electricity transmission and distribution to rural villages in the Atlantic province of Benin).

Gender was rarely targeted. The gender of borrowers, for the project focussing on lending to SMEs and individuals, is not noted or emphasised in the reporting although in many of the
countries, gender is a key issue for improving access to finance

Within improving access to finance, the prudent practices of the IFIs and their partner financial institutions led to a tendency to target existing customers, and hence not to focus on less privileged market segments.

**Recommendations**

**Recommendation #1 Focus strongly on the additionality of the blending grant.**

The early projects often failed to make the additionality of blending grants explicit. Yet this should be a key focus of any blending application – to truly focus on “what the project will have with the grant that it otherwise would not have”. This recommendation can be achieved through action such as:

- Emphasise the need for the grants to solve a problem (such as a market failure or a failure to provide public goods) that cannot be as well solved with just a loan. This has already been recognised in the latest application form, where topic 29 requires the IFI to explicitly address additionality.
- Continue vigilant and close scrutiny in the technical assessment meetings at facility level.
- Consider using resources for post construction follow up on sustainability issues.
- Expand the use of risk sharing approaches; in particular, scrutinise the use of investment grants so that they are only used where highly justified and, consider innovative measures to bring technical assistance under loan rather than grant finance, including the use of revolving funds for grant financed project preparation work.

**Recommendation #2 Expand the number and specialisation of IFI partners and ensure that training is provided in line with the expansion**

Rationale: Expanding the number of financial institution partners should increase the range and volume of blending applications presented to the facilities – noting that very few have been rejected. This recommendation can be achieved through action such as:

- Encourage regional non-European development banks to participate actively and where relevant lead on blending (AfDB for AfIF, IaDB and CDB for the CIF).
- Where relevant brief, build awareness and support other IFIs that have a potential for future blending operations such as AfDB).
- Explore new partnerships with European development financial institutions and other European institutions.
- Explore, in the longer term, the potential of partnerships with civil society based organisations that have a robust track record of managing loan funds (this could if well managed bring a new dynamic to implementation of recommendation #5 on enhancing the poverty impact).

**Recommendation #3 Sharpen the alignment of the blending project with national policies.**

Although blending projects were broadly aligned with the facilities’ objectives, the explicit link between the project and national objectives and priorities was often not clear enough. This recommendation can be achieved through action such as:

- Increase the awareness of IFI staff and EU delegation staff.
- Pay special attention to topic 22 in the application form which requires explanation of policy alignment, ensuring that this relates not only to the facilities’ policy objectives but also to relevant national policies.
- Ensure that the technical assessment meetings scrutinise this aspect in detail.

**Recommendation #4 Build on the advances of the post 2014 blending guidance framework and continue with improvements and innovation in project design in order to ensure that blending projects optimise the potential to achieve the development cooperation goals set out by the EU.**

The development potential of blending has not been fully mobilised in the past. The findings of this evaluation support the application of the approaches outlined in the new guidance framework. It is noted however, that whilst the guidelines are well-conceived and respond to most of the challenges faced by blending projects, it is also important not to over-complicate blending operations and rely on a lean approach combined with skill building within the IFIs.
This recommendation can be achieved through action such as:
- Incorporate the development and transition aims more explicitly in the objectives, intervention logic and results matrix, policy reform and transition goals;
- Undertake capacity assessments and incorporate capacity development outcomes in the results matrix;
- Subject the assumptions, the justification of the grant and the assessment of risks to sharper scrutiny

Recommendation #5 Expand the use of risk sharing instruments to financial intermediaries selected for their strategy and policies with respect to pro-poor and pro-development risk taking. This can be achieved by actions such as:
- Using special risk cushions to crowd-in private funding making further effort to make that more efficient (i.e. a lower ratio of C-shares to private investments coming from a wider range of risk tolerant private investors)
- Extending credit guarantees and focusing future innovation on creating sustainability for when the guarantees are reduced
- Improving access to finance for the unbanked by selecting financial intermediaries for their strategy, policies and risk management approach for first-time borrowers, as well as because of their status as effective banking or micro-financing institutions.

Recommendation #6 Achieve greater development impact through blending projects by placing greater focus on job creation and poverty alleviation.

Blending projects generally aimed at wider macro-economic development rather than grass root targeting of the poorest of the poor for which other instruments are usually better suited. Although blending projects lead to job creation this was not monitored (it is now through the new results framework) and job creation effects are not optimised. It is important to recognise that although blending cannot address all issues and has a comparative advantage in serving large scale economic development aims, there are still many opportunities to also optimise impact on poverty alleviation and the creation of decent work. This recommendation can be achieved through action such as:
- Scale up the blending resources available for projects serving poor populations and addressing root causes of poverty in low and lower medium income countries including employment related issues – adjusting the grant levels where justified;
- Analyse and understand the poverty and employment profile in the project-affected area consider explicitly the needs of the poor and measures that protect the poor against potential adverse effects;
- Where projects have an infrastructure or macro-economic development focus and in the spirit of the European External Investment Plan, examine and if relevant support and ensure that advantage is taken of the downstream employment prospects e.g. an improving electricity supply that can expand SME activity;
- Select partners such as micro finance institutions, where relevant to do so, that will be effective in reaching the poor.

Recommendation #7 Undertake assessment of the partner’s procurement and contracting systems to better align the strategy for PMUs and use of IFI procurement and other procedures so that they strengthen national systems.

Much of the transaction costs and frustration experienced by implementing partners on blending projects arose from IFI procurement and other management systems. Whilst it is recognised that the IFIs assess partner capacity, rely on partners to implement the procurement and provide technical assistance where there is weakness; there is still further opportunities to strengthen the capacity of partners and partner systems rather than bring in new staff and substitute with new systems. This recommendation can be achieved through action such as:
- Assess the partner institutional capacity and fiduciary performance;
- Assess safeguards that could be taken such as strengthening partner systems before replacing them with external IFI systems (where relevant link to, support and take advantage of budget support to public financial management and administrative reforms that are being supported by the EU and others);
• Develop an institutional and capacity development strategy that ensures that even if external IFI systems are used, residual capacity for project management will remain where such capacity is needed in the future.

**Recommendation #8** Take a pro-active stance on visibility where such visibility is particularly important or likely to lead to political capital or other gains.

Visibility rules are generally followed by the IFIs but the in-country perception of the projects rarely reflects the involvement of the EU. If the range of IFIs are expanded beyond the European IFIs, this low visibility effect will become even stronger. This recommendation can be achieved through action such as:

• Encourage in the project design a continuous outward accountability to the beneficiaries and political level on the evolution and performance of the project. This means that the project should advertise itself locally and explain to politicians and to the beneficiaries and others what it is doing, why it is doing it, and what it has achieved. It should invite for example local schools and communities to the site and get them involved.

• Prioritise active engagement of EU delegations in seminars, conferences, press releases, for projects where greater visibility and recognition is likely to bring political capital or other benefits;

  Carry out visibility surveys and undertake corrective action depending on the perception found.