Decent work and development finance

Background paper for Decent Work and Labour Standards Forum
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Alastair Usher and Jean-Baptiste Andrieu

Ergon Associates Ltd
8 Coldbath Square, London, EC1R 5HL
+44 (0)20 7713 0386
www.ergononline.net

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> “With annual investments of approximately $25 billion [...] the DFIs have been relatively neglected by DFID and other shareholders, and present a strong opportunity for future work.”DFID Private Sector Development Strategy 2009, ‘Prosperity for all: making markets work’

Key points

1. Development Finance Institutions (DFIs) are public agencies that invest in the private sector in developing and transition countries. The term DFI refers to a variety of institutions: multilateral institutions such as the International Finance Corporation (IFC – part of the World Bank Group), regional institutions such as the European Bank for Reconstruction and Development (EBRD) and the Asian Development Bank (ADB), and bilateral institutions such as DEG in Germany and CDC in the UK.

2. DFIs aim to bridge the gap between commercial investment and state development aid. Their rationale is twofold: to be ‘additional’ – that is, to invest in developing countries where commercial investors perceive risks to be too high, without some form of official collateral; and to be ‘catalytic’ – to spur other investment in developing economies. While distinct from official development agencies due to their focus on profitability and market rules, DFIs share a common interest in fostering economic growth and sustainable development.

3. DFIs provide a broad range of financial instruments in developing countries, such as loans (‘debt finance’) or guarantees to investors and companies, buying shares in companies (‘equity participation’) or investment funds, and providing financing for infrastructure projects (‘project finance’). The type of instruments offered varies by institution. The vast majority of IFC investment is in the form of loans; just over half of European DFI lending is in the form of equity. DFIs also commonly provide funds for technical assistance (also known as technical co-operation) to strengthen enterprise capacity, including management capacity.

4. The UK has a unique DFI structure. The UK DFI, CDC, which is owned by DFID, does not make investments directly but operates via investments in a number of fund managers, the biggest of which is Actis. These managers provide private equity to businesses in developing countries.

5. Financing from DFIs is increasingly in demand. Global economic crisis is affecting developing and transition countries. The availability of finance from private banks and other sources has noticeably declined. Donor support for development finance has increased substantially. It is estimated that the total value of multilateral and bilateral development finance in 2007 amounted to US$ 50bn (ODI, 2008).

6. DFIs are increasingly recognised as important actors in the broad Decent Work Agenda: access to productive employment and income opportunities; rights at work, particularly with respect to the core labour standards; systems of social protection; and a voice at work through social dialogue. EBRD and European Investment Bank (EIB), as European institutions, are guided by the EC commitment to decent work promotion in external policies. EBRD currently has a more detailed policy than EIB on employment and decent work.

7. The number of jobs created and sustained by development finance is material. A recent study indicates that the European bilateral DFIs together sustained close to two million direct and indirect full time jobs through their investments in 2008. In many cases to date, employment statistics have been used as the primary indicator of DFI impact on decent work.

8. The vast majority of DFIs have broad and credible commitments to uphold labour rights in their investments, typically including the ILO core labour standards, occupational health and safety, and substantive working conditions. Most prominent in the standards adopted are IFC Performance Standard 2 (PS2) and EBRD Performance Requirement 2 (PR2). The grouping of European Development Finance Institutions (EDFI) – which includes CDC – have signed up to the IFC standards in co-financed projects. Importantly, the IFC standards have also been adopted by a growing number of commercial investment banks, under the guise of the Equator Principles.

9. While there remain some gaps in investment policies on labour rights, and the international benchmark standards of the IFC are currently under review, the debate is now primarily focused on the meaningful implementation and monitoring of labour standards commitments in workplaces benefiting from DFI investment.

10. All DFIs have some process for assessing risks and impacts related to the projects they are financing. There is a growing understanding of the ways in which labour standards issues can be assessed; there is less experience of monitoring and client reporting.

11. Several DFIs are responsive to trade union engagement. IFC has an effective relationship with Global Unions and recently established a stream-lined online communication tool for trade unions reporting breaches of IFC Performance Standard 2. Dutch DFI FMO and German DFI DEG have trade union representatives on their supervisory boards.

12. Other DFIs can learn from the experiences of leading institutions. CDC's 'intermediated' structure, whereby all funds are disbursed through commercial fund managers, presents a challenge to implementing CDC's operating policies and establishing clear lines of communication from investment to investor. Since 2008, CDC has started the development of new systems of impact assessment and evaluation of compliance with its Investment Code, which includes a section on labour rights.

13. Decent work describes an important way to understand the actual and potential 'development impact' of DFI activities, as it encompasses both (quantitative) job creation and (qualitative) labour standards, and as such can usefully be incorporated in DFI strategy, impact evaluation and reporting.

14. Because of the structure of much development finance, which often responds to client requests, there is not always detailed prioritisation of decent work factors – such as the *sort of jobs created* – in project design. To date, much DFI work on 'labour issues' has taken the form of mitigating risks to a project which is already fully or mostly formed. DFIs can fruitfully give greater and earlier attention to decent work factors – both to improve development outcomes, and to facilitate subsequent compliance with their own labour standards requirements.

15. DFIs' commitments on labour rights have the potential to be a useful tool to help enforce workers' rights. As ITUC notes, unions can play an important role in ensuring that DFI clients meet their labour standards obligations. As of August 2009, unions had registered complaints of labour rights violations, or requested assurances, for 22 proposed IFC investment projects (see Annex 1). One key question for the Forum to consider is how DFIs can best monitor respect for labour rights in their investments while recognising the primacy of industrial relations systems and established labour dispute resolution mechanisms.

16. With the exception of some trade unions, most pressure groups are focused more on environment and the community aspects of development finance, in part because the 'labour agenda' is still relatively new within development finance. There are several different areas for potential advocacy. For instance, while the majority of DFIs have adopted comprehensive policies on labour rights, some institutions' policies are less well-developed than the leaders in the field, including those over which DFID has substantive influence. Further, stakeholders have an important role in advocating for greater resources to be applied to decent work concerns in the DFI project cycle.

17. Forum members, by definition, have expertise on labour rights and decent work. There is ample scope to improve the level of cross-communication between Forum members and the development finance community. DFI policy formulation is commonly open to stakeholder consultation. Policy reviews are currently underway at IFC and at ECGD (the latter due to end in March 2010): both of these processes are open to expert stakeholder consultation. The OECD 'Common Approaches' for export credit agencies are due to be revised through 2010. In the case of EBRD, all stakeholders are invited to comment on draft country and sector strategies.

18. DFID has an important governance and financing role in several of the DFIs discussed in this paper. The Forum can consider means to engage with DFID over the Department's role in influencing DFIs' policies and practices relevant to decent work concerns, including those of the UK DFI, CDC.

1. Introduction

This paper seeks to fulfil a dual purpose: firstly, to explain the sometimes complex workings of development finance to a broader audience and to look at the decent work impacts of development finance in a variety of contexts; second, to explain the relevance of the Decent Work Agenda for the provision of development finance to private sector companies in developing countries. The paper is structured as follows:

- An overview of the meaning and scope of decent work
- An overview of what development finance is, and the kinds of financial instruments, transactions and beneficiaries associated with development finance
- A review of the UK dimension of development finance both in terms of influence of UK government in relation to other organisations, and direct engagement with bodies such as CDC and ECGD
- A consideration of the potential interactions between principles of decent work and development finance
- A review of important new developments related to the labour dimension of development finance, including a review of the standards required by IFC, EBRD and other bodies
- Conclusions as to the possible areas and activities for engagement with development finance for members of the DWLSF

2. What is decent work?

For many poor people, work is a major route for escaping poverty. However, economic growth, which has been a focus for donors, including DFID, does not inevitably result in more and better jobs. The majority of poor people in the developing world already have jobs: the problem is that these are predominantly in the informal economy, where conditions are usually insecure and incomes inadequate. Eradicating poverty is therefore not solely a question of generating economic growth and employment opportunities but rather making sure that both the quantity and quality of available work is such that it can lead to poverty reduction.

In response to this challenge, the Decent Work Agenda, developed by the ILO, proposes an approach to development that emphasises fair and sustainable working opportunities. Decent work is conceptualised as having four constituent pillars, which are interdependent and mutually reinforcing:

- Access to productive employment and income opportunities;
- Rights at work, particularly with respect to the core labour standards;
- Systems of social protection; and
- A voice at work through social dialogue.

The Decent Work Agenda therefore is an approach to development that emphasises employment that is accompanied by rights, representation and protection. While decent work is applicable to both developed and developing countries, different elements may need greater focus depending on the particular challenges in a given region, country, sector or workplace.

Importantly, decent work represents an approach to development as well as an outcome. The Decent Work Agenda entails building respect for international labour standards and social dialogue into development processes, rather than seeing them as a future goal or inevitable outcome of economic development. This is not only a question of social justice, but also an important contributory factor in social and economic development: in many ways, labour standards and social dialogue help to enable development processes, by encouraging stronger standards of governance and promoting social development.

Uptake of decent work within the international development agenda

The concept of decent work has achieved high-level international endorsement as an objective of the development agenda, most notably with its integration into the Millennium Development Goals (MDGs). In recognition of the importance of decent work for poverty reduction, MDG1 now includes a target to '*achieve full and productive employment and decent work for all, including women and young people*', along with four measurable indicators. These relate to both the quantity of employment, and also to its quality in terms of wage levels for workers and degree of informality. Decent work has also featured prominently in international policy statements on the global financial crisis, where the importance of employment and social protection strategies in safeguarding livelihoods and contributing to recovery has been underlined.

3. What is development finance?

Development finance aims to bridge the gap between commercial finance (provided by banks or other private sector investors) and official development assistance (provided by governments). Development Finance Institutions (DFIs) are defined here as national or international public agencies that invest in the private sectors of developing economies.[1]

It is useful to distinguish between two types of DFI: bilateral and multilateral. The bilateral DFIs are funded by individual states and serve to implement their government's development and co-operation policy. The multilateral DFIs are usually focused on particular regions, usually have greater financing capacity and provide a forum for co-operation between governments. They fund both private and public sector projects.

The International Finance Corporation (IFC), the private sector arm of the World Bank Group, is the global multilateral DFI. Other multilateral DFIs have a regional focus, and include the Inter-American Development Bank (IDB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Asian Development Bank (ADB) and the Caribbean Development Bank (CDB). It should be noted that the bulk of RDB lending is to governments whereas IFC lending is only to the private sector, as is the vast majority of EBRD lending.

1 We use the phrase 'developing countries' to refer to all economies that receive development finance, recognising that these include the 'transition' economies of Eastern Europe and the CIS, as well as 'emerging' economies such as BRIC – Brazil, Russia, India and China.

Some bilaterals are wholly owned by government, such as CDC, the UK development finance institution, in which DFID has a 100% stake (although it has a high degree of operational independence – see below). Other bilaterals are majority owned by national governments or partly owned by the private sector, such as FMO or COFIDES, the Dutch and Spanish DFIs respectively, whose shareholders include large commercial banking groups as well as government.

KEY DFIs – BY SCOPE AND TOTAL INVESTMENT PORTFOLIO

		Total private sector portfolio (US$, FY 2008)
Multilateral DFIs	IFC - International Finance Corporation	US$ 11.4bn
	MIGA - Multilateral Investment Guarantee Agency	US$ 1.4bn (guarantees)
Regional DFIs	EIB - European Investment Bank	US$ 8.8bn (sum of public and private investments outside EU)
	EBRD - European Bank for Reconstruction and Development	US$ 6.2bn
	IADB - Inter American Development Bank	US$ 2.4bn
	ADB - Asian Development Bank	US$ 1.7bn (2007)
	AfDB - African Development Bank	US$ 1.4bn
Bilateral DFIs	DEG – Germany	US$ 6.4bn
	FMO – The Netherlands	US$ 6.1bn
	CDC – UK	US$ 1.5bn (excludes cash)
	PROPARCO – France	US$ 1.15bn

Sources: Individual DFI annual reports, accounts and websites

Unlike commercial banks, DFIs have no depositors; their investment capital comes exclusively from their shareholders (governments) and from return on their investments and loans. For the multilateral DFIs, the member countries subscribe capital which is usually proportionate to the size of their own economies and they then have commensurate influence in terms of voting power. In the case of the UK, the government contributes to IFC (through the World Bank IDA), EBRD, ADB, AfDB, IADB and CDB.

DFIs provide funds – either as loans, equity participation or guarantees – to foreign or domestic clients. DFIs are demand-driven: their portfolio is largely a reflection of client demand. The clients of the DFI initiate or develop projects in sectors and countries in which commercial banks are reticent to make medium- to long-term investments without some form of security through official involvement. DFIs also typically provide substantial advisory services (often known as 'technical cooperation' or 'technical assistance') to build the private sector in developing countries; these services may include HR management capacity building.

The majority of DFIs have an express development mandate; the major exception is EBRD, which seeks to foster economic 'transition'. The rationale for DFIs' involvement in private sector development is that private companies are often the engine of economic growth and development. The investments DFIs make and stimulate are intended to assist in creating jobs, as well as transferring technology and business knowledge. Further, by enabling sustainable and commercially successful business, DFIs support tax-paying companies which can generate important revenue to country governments.

DFIs seek to be catalysts, aiming to demonstrate to commercial financial markets that it is possible to invest in developing countries and still make a risk-adjusted profit. In the years from 2003 to 2008, for instance, gross returns on IFC's lending portfolio averaged 17% (though this fell in 2009 to 3.1%); CDC's gross return on shareholder equity averaged 20.5% from 2004-2007.

EXAMPLES OF SOME RECENT PROJECTS FUNDED BY SELECTED DFIs	
IFC - International Finance Corporation	*Zambia* > US$6 million in equity finance for Kiwara Plc, a London-based mineral exploration company, for exploring and developing base metals deposits.
	Bangladesh > Loan of up to US$15 million for expansion of production capacity by PRAN, a food and beverage company.
EBRD - European Bank for Reconstruction and Development	*Kazakhstan* > US$ 75 million framework facility in the form of dedicated credit lines to local financial institutions for on-lending to private sector companies to finance investments in sustainable energy.
	Poland > US$50 million senior syndicated loan to Can-Pack SA, a producer of aluminium and steel can packaging to finance the construction and equipment of a brownfield aluminium can production factory near Moscow.
ADB - Asian Development Bank	*Cambodia* > US$18 million loan to rehabilitate small-to-medium-scale irrigation schemes and other water control infrastructure.
DEG – Germany	*India* > Co-finance (loan) for Amalgamated Bean Coffee Trading Company Ltd (ABCTCL) for the expansion of coffee bars in 2003 and further investments; ABCTCL buys from about 10,000 smallholder coffee-planting families.
FMO – The Netherlands	*Rwanda* > €4 million senior loan from to be used for on-lending to clients who wish to buy small bio-digesters.
CDC – UK	*Kenya* > $7 million investment (via Aureos fund manager) in Athi River Steel producing hot rolled steel products from recycled scrap metals; employs over 900 people.
Sources: DFIs	

DFIs' environmental & social criteria

DFIs are increasingly attentive to promoting sustainability in their investments – in the areas of environmental and social responsibility, as well as corporate governance. This commitment is a direct result of their (differing) development mandates. As explained in Section 5 below, almost all DFIs now have commitments, at a minimum, to require compliance with the Core Labour Standards in the workplaces they invest in. This process has been consolidated by the advent of 'Performance Standards' for recipients of development finance – a process initiated by the IFC.

The IFC Performance Standards usefully reflect developments occurring in other fields – such as 'ethical trade' in global supply chains – recognising that enabling meaningful participation and good management systems are vital practical steps to ensuring compliance with both environmental and labour standards. Moreover, the European multi-lateral institutions, such as EBRD and EIB, are guided by EU policy. In May 2006, the EC Communication 'Promoting decent work for all' stated that '*it will harness its external policies, its development aid and its trade policy for [the promotion of decent work]*'.

4. The UK government and development finance

Why private sector development?

DFID's engagement with the private sector in developing countries is informed by the view that economic growth is the principal long-term sustainable way out of poverty and evidence shows that it is the private sector that drives economic growth. For DFID, increased private investment is vital to generate the jobs, income and taxes to lift people out of poverty and away from dependency on aid. DFID's most recent strategy communication on the subject – '*Prosperity for all: making markets work*' (2009) – emphasises the importance of private sector employment:

> '*Vibrant, competitive markets populated by dynamic private companies offer the most effective way to create wealth, jobs and prosperity for all on a sustained basis. Nine out of ten jobs in the developing world are in the private sector.*'

Support for DFIs represents one of the most important ways in which the UK government, through DFID, seeks to stimulate private sector development in developing countries. DFID is involved with development finance activities in two main ways:

- Through its support for, and role in the governance of, the multilateral DFIs including the World Bank IFC and EBRD
- Through its ownership and role in the governance of the UK's DFI, CDC

DFID's role in development finance is overseen and administered by the Global Funds and Development Finance Institutions Department (GFDD), which is part of the International Finance and Development Effectiveness Division (IFDE). GFDD leads on DFID's policy on Development Finance Institutions (DFIs), including managing DFID's shareholder and corporate interest in IFC, EBRD, MIGA and CDC. DFID's relationship with the regional development banks is managed by the International Financial Institutions Department (IFID), also within the International Finance and Development Effectiveness Division (IFDE).

DFID's role in international DFIs lending to the private sector

World Bank Group – IFC

While the World Bank Group lends principally to governments, its lesser-known division, the International Finance Corporation (IFC), provides direct support to private businesses in developing countries. The UK partners with IFC to help developing countries build stronger private sectors as a way to reduce poverty, through technical assistance and advisory services. IFC's main UK counterpart in the delivery of this work is DFID.

DFID and IFC are increasingly working together. This includes joint programmes on private sector development in countries such as Yemen and Bangladesh. With the IFC, DFID has also pioneered the use of gender and growth assessments which focus on analysing hindrances to women's economic activities as entrepreneurs, producers and in the labour market. As a result a number of participating countries have undertaken specific measures to improve the investment climate for women in business, and removed barriers to women's employment. These changes have included reform of requirements for security on loans, and alterations to the practice of land titling.

In its 2009 private sector development strategy, DFID describes itself as an 'activist shareholder' in the World Bank Group. DFID played a key role in IFC management's explicit endorsement of a mission statement referring to poverty reduction. Since 1998, the IFC has increased its focus on poorer 'frontier countries'.

DFID DONOR SUPPORT FOR IFC	UK support for IFC is through its contribution to trust funds administered by the World Bank Group. In 2008, the UK continued to be the largest donor to World Bank Trust funds, contributing around £556 million.
DFID GOVERNANCE ROLE IN IFC	IFC's member countries, including the UK, guide IFC's programs and activities through a Board of Governors and a Board of Directors. The UK appoints one governor and one alternate. The UK government relationship is with the World Bank Group – through the UK delegation to the Bank, UKDEL – and is overseen by DFID. Since September 2008, there has been a separate Director of the UKDEL for the World Bank – previously the Director had responsibility for both Bank and IMF – reflecting '*the central importance of the World Bank to achieving the MDGs, the increased level of UK resources being channelled through the Bank and the wide-ranging scope of our engagement*'. The new Director is a DFID appointee.

European Bank for Reconstruction and Development (EBRD)

The European Bank for Reconstruction and Development (EBRD) was established in 1991 to foster the transition to market-based economies, with a specific 'transition' mandate which explicitly includes political reform and environmental improvement. The EBRD invests in 30 countries from central Europe to central Asia. The EBRD is the largest single investor in the region, investing mainly in private enterprises, usually together with commercial partners. It is headquartered in London.

The UK government's current institutional objectives for the European EBRD are set out in the 2007 statement of intent. This notes that, unlike other multilateral development banks (MDBs), the EBRD does not have a poverty reduction mandate. DFID commits to help the Bank to enhance its awareness of the social dimensions of transition, improve its capacity to assess the impact of its investments and do more within its mandate to raise the living standards of the people in the region. EBRD confirms that DFID funding has been instrumental in helping EBRD establish expertise and processes to assess and monitor project performance on labour, gender and other social issues.

The UK is the fourth largest bilateral supporter of the EBRD's Technical Cooperation (TC) Funds Programme. TC funds are grants from donors that complement lending in addressing specific aspects of individual investments and larger initiatives to underpin the transition of former communist countries to market economies. The UK has contributed €40.5m to bilateral funds, and a further €22m to multi-donor arrangements.

DFID DONOR SUPPORT FOR EBRD	As at April 2009, the value of joint UK-EBRD investments was €14.8 bn. The UK has provided a total of €86.6 million for co-financing of EBRD investments in the form of grants, export credits, equity and loans (the latter two through multi-donor arrangements).
DFID GOVERNANCE ROLE IN EBRD	The UK is a founding member of the EBRD, with an 8.6 per cent capital share and has a representative on the Board of Directors, appointed by DFID. Each year, DFID sets its own objectives for working with the EBRD as a shareholder and on the board of directors.

European Investment Bank (EIB)

With a portfolio value just under €60bn in 2008, the European Investment Bank (EIB) is one of the largest multilateral financial institutions in the world. Although primarily intended for lending within the EU, the Bank's Statute provides for lending outside the Community in support of the European Union's external policy objectives. The balance between internal and extra-EU lending is guided by the Bank's policy statements, which propose a ratio of 90:10. The majority of EIB lending outside the EU is directed towards African, Caribbean and Pacific (ACP) countries. There are EIB loans in most of the 78 ACP countries, spread over energy, agriculture, water, transport and construction projects.

The 2009 DFID White Paper ('Building Our Common Future') proposes to boost the role of the European Investment Bank (EIB) in international development. '*The UK will work with the EIB, European Parliament and shareholders to ensure that the EIB can lend an extra €2 billion to support development. The EIB should support sectors such as reducing carbon emissions through support to cleaner technology, small and medium enterprises, and access to credit for the poor*' (6.27). Given a historically low level of reporting on development impact and effectiveness by EIB, this has generated some concern among civil society stakeholders.

UK SUPPORT FOR EIB	The shareholders of the European Investment Bank are the 25 Member States of the European Union.
UK GOVERNANCE ROLE IN EIB	The UK is presented on, and can influence through, the Board of Governors, Board of Directors and the 'Article Committees'.

Regional Development Banks

- African Development Bank (ADB)
- Asian Development Bank (ADB)
- Caribbean Development Bank (CDB)
- Inter-American Development Bank (IADB)

The Regional Development Banks (RDBs) were founded in the 1960s with the aim of promoting development and growth in their respective regions. They invest in both public and private sector projects. The UK is a shareholder of all four banks and contributed some £98 million to them in 2007. All four regional development banks use the Millennium Development Goals (MDGs) as the benchmarks for their funding activities. The revised MDG1 include a clear reference to decent work promotion.

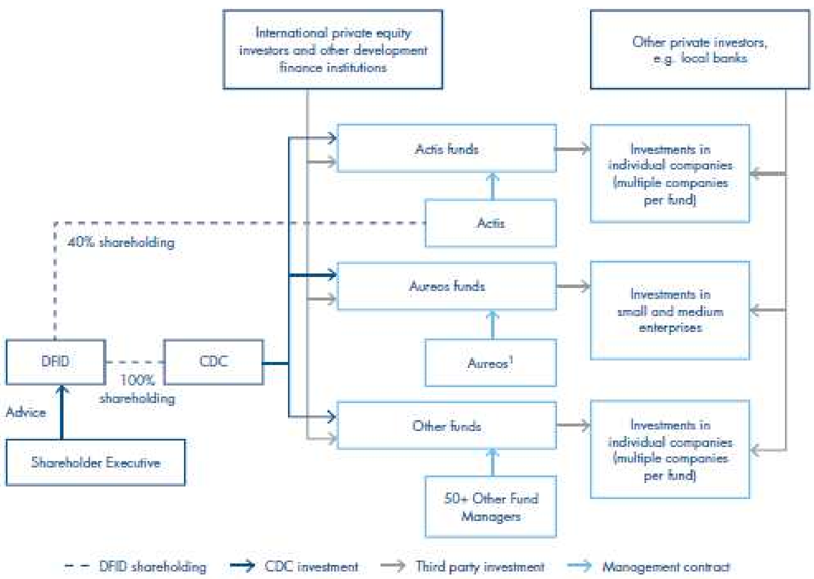
DFID DONOR SUPPORT FOR RDBs	DFID's financial support to the RDBs takes place within three- or four-year periods called 'replenishments'. For instance, the most recent replenishment of the African Development Fund (AfDB) took place in 2007, with the UK contributing £417 million over 2008-2010; the most recent replenishment of the Asian Development Fund (ADB) took place in 2008, and the UK contributed £109 million over 2009-2012.
DFID GOVERNANCE ROLE IN RDBs	Each donor to each bank has the right to nominate a governor to the bank's board. The Secretary of State for International Development is the UK Governor for each of the banks. The UK Governor contributes to oversight of the banks' activities and is responsible for ensuring the banks fulfil their remits in line with their stated aims.

DFID and CDC

CDC is the UK development finance institution, wholly owned by the UK Government, through DFID. It represents a core part of DFID's strategy to reduce poverty by supporting private sector development in its partner countries. DFID uses CDC to address a shortage of investment finance in developing countries: CDC's mission is to go where other investors irrationally perceive risks to be too high or returns too low, in order to demonstrate that profitable opportunities exist.

Originally founded in 1948 as the Commonwealth Development Corporation, since restructuring in 2004, CDC has operated as a 'fund of funds'. This means it does not invest directly in companies, but places its capital with a range of 59 specialised professional private equity fund managers. Private equity funds provide CDC and other investors with an ownership share in the businesses in which fund managers invest. That capital is recovered when such a shareholding is sold several years later.

As part of the restructuring process, the majority of CDC's staff were 'spun out' into two privately-owned private equity fund management companies, Aureos and Actis. Actis is CDC's largest fund manager, and CDC is the largest investor in Actis, which focuses on investment in larger companies in emerging markets. DFID holds 40% of the shares and Actis management the rest. The other fund manager spun out of the former CDC was Aureos, a joint venture between CDC and Norfund (the Norwegian Investment Fund for Developing Countries). Aureos focuses on investment in established small to medium-sized businesses (SMEs).



Source – National Audit Office

The profile of the fund managers with which CDC places its funds varies significantly. 42% of CDC's 59 private equity fund managers are managing private equity funds for the first time. Key for CDC is that their willingness to engage with and support new fund managers acts as a stamp of approval for other investors to follow suit.

CDC CAPITAL INVESTED BY FUND MANAGERS (%)		TOTAL CAPITAL COMMITTED TO CDC'S FUND MANAGERS 2004-08		TOTAL CAPITAL COMMITTED TO ACTIS' FUNDS	
Actis	49%	CDC	US$ 7,137m	CDC	US$ 3,361m
Aureos	6%	Other DFIs	US$ 1,433m	Other DFIs	US$ 80m
57 other fund managers	45%	Commercial investors	US$ 19,718m	Commercial investors	US$ 2,789m
Source: CDC Development Report 2008					

The CDC business model is unique among DFIs, the majority of which favour loan finance and technical support. While other similar institutions such as OPIC (US) also invest significant proportions of their capital through private equity fund managers, and several DFIs and IFIs are increasing their level of intermediated finance, no other DFI employs this approach for its entire portfolio.

DFID's objective for restructuring CDC was to achieve 'a step change in CDC's economic impact and catalytic role': CDC's resources are less than 1% of international private equity to developing countries, so for CDC to have a bigger impact, it would have to influence the behaviour of commercial investors. CDC therefore aims to invest through private equity fund managers as are available to commercial investors, so that others may follow.

CDC: TRANSITION FROM DIRECT LENDING TO AN INTERMEDIATED BUSINESS MODEL

DFID acknowledges that '*private equity might at first seem an odd choice of development vehicle*'. Since the restructuring of CDC in 2004, there has been considerable civil society concern over the choice of the private equity model for CDC's development finance mission from organisations including War on Want and the Tax Justice Network. DFID contends that this model is 'actually highly developmental' because:

- It is a long-term investment (typically over 7-10 years) and requires continuous engagement by fund managers
- CDC fund managers play a hands-on role in nurturing the companies within their portfolio by adding value through business expertise and promotion of responsible business practices
- Private equity's pursuit of profitable returns can, where successful, stimulate large follow-in investment flows into firms in developing countries
- Equity investment, even when unsuccessful, does not (unlike foreign loans) increase a developing country's indebtedness or create pressure on a country's balance of payments

See: www.dfid.gov.uk/About-DFID/Who-we-work-with1/CDC

CDC is self-financing, having received no additional UK government funding since 1995. CDC invests largely in sub-Saharan Africa and South Asia in a range of sectors including retail, financial services, agriculture and manufacturing.

At year end 2008, CDC reports that its investments currently support some 681 businesses, employing almost one million people directly. Moreover, NAO (2008) research suggests that a greater share of CDC's investments are in poor countries (LDCs and other low incomes countries) than any other DFI: 66% as of 2007, compared to 27% for DEG, 30% for FMO and 22% for IFC.

DFID's role in CDC governance

DFID secures its interests as shareholder through representation on the CDC Board, which is responsible for approving and monitoring the investments made by the company. DFID appoints the Chairman of the Board and nominates two of the four Non-Executive Directors.

DFID does not interfere in CDC operations or operational investment decision-taking. This is a long-standing DFID policy decision and is designed to demonstrate to the private equity markets in which CDC operates, and to other investors, that CDC goes about its business in a commercial manner and without political interference. Instead, CDC's Investment Policy – see below – is the principal instrument through which DFID guides CDC investments so as to grow viable businesses in poor countries, and in support of Government objectives for poverty reduction.

For DFID, since its restructuring in 2004 until 2008, financial performance was used as the principal indicator of CDC's development impact. NAO (2008) noted that '*CDC has less information on the non-financial aspects of the development effectiveness of its investments than do some other DFIs. CDC has not specified a set of development impact indicators, unlike the International Finance Corporation's listed equity arm, which also makes indirect investments through funds*'.

DFID states that CDC has improved its monitoring in this area, having recruited a team of specialists in development impact evaluation. Since April 2008, CDC has monitored routinely several selective indicators of development performance, including employment and taxes, based around the parameters of Financial Performance, Economic Performance, ESG Performance and Private Sector Development. CDC has also commissioned an independent audit of its processes to implement the new Investment Code (see below).

CDC'S INVESTMENT VALUE BY SECTOR, 2008 (£M)	
Consumer goods & services	152
Financial services	151
Energy & utilities	126
Industry & materials	127
ICT	83
Infrastructure	80
Mining	64
Healthcare	55
Agribusiness	49
Microfinance	25
Cleaner technologies	16
Source: CDC Development Report 2008	

CDC Investment Policy

In 2008 DFID agreed a new Investment Policy for CDC which requires more than 75% of total investment by CDC until 2013 to be in Low Income Countries (LIC) and more than 50% to be in Sub-Saharan Africa. CDC's fund managers currently invest over 70% of its resources in poor countries. CDC has limited influence, however, over the actual investments that its fund managers make within the broad geographical criteria. This resulted in the House of Commons Public Accounts Committee (2009) raising concerns, that only 4% of its resources are invested in small and medium enterprises.

It should be noted that Actis, the largest CDC fund manager and home to CDC's 'legacy' projects, has its own ESG policy which commits the fund manager inter alia: to require the businesses in which Actis invests to treat all of their employees and contractors fairly, and to respect their dignity, well-being and diversity; and to work towards full compliance of Actis investments with the International Labour Organisation Fundamental Conventions and with the UN Declaration of Human Rights.

CDC Investment Code

CDC's commitments to non-financial performance are outlined in its newly revised Investment Code, which came into operation in 2009. CDC states that 'responsible investment and business practices are crucial to ensure that investments in poor countries generate these development effects without destroying the environment and while ensuring safe and fair working conditions for employees'. The Investment Code sets out CDC's principles, objectives, policies and management systems for responsible investment with respect to ESG factors. The Code replaced and updated CDC's previous Business Principles, and reflects the view that businesses in which CDC's capital is invested should work on improving their practices on ESG in line with international good practices over the duration of the investment by CDC's fund managers. Accordingly, the Investment Code does not require a priori compliance with core conventions but, rather, commits CDC's Fund Managers to '*encourage the businesses in which CDC's capital is invested to work over time towards full compliance with [ILO] Fundamental Conventions*'. The section of the Code on labour standards is included below:

CDC INVESTMENT CODE EXTRACT: LABOUR AND WORKING CONDITIONS	
Objectives	• To require the businesses in which CDC's capital is invested to treat all their employees and contractors fairly and to respect their dignity, well-being and diversity. • To encourage the businesses in which CDC's capital is invested to work over time towards full compliance with the International Labour Organization ("ILO") Fundamental Conventions and with the United Nations ("UN") Universal Declaration of Human Rights.
Policy	Businesses in which CDC's capital is invested will: • comply with applicable local and national laws (as a minimum); • not employ or make use of forced labour of any kind; • not employ or make use of harmful child labour; • pay wages which meet or exceed industry or legal national minima; • treat their employees fairly in terms of recruitment, progression, terms and conditions of work and representation, irrespective of gender, race, colour, disability, political opinion, sexual orientation, age, religion, social or ethnic origin, or HIV status; • allow consultative work-place structures and associations which provide employees with an opportunity to present their views to management; and • for remote operations involving the relocation of employees for extended periods of time, ensure that such employees have access to adequate housing and basic services.
Source: CDC Investment Code	

CDC's intermediated approach raises a series of challenges. Fund Managers do not themselves have an express development mandate, but rather a geographical mandate instructed by CDC; the CDC Investment Policy agreed with DFID stipulates countries where investment must be made by Fund Managers acting for CDC, but does not specify economic sectors (eg agriculture rather than ICT) or the profile of investment (eg SMEs rather than MNEs). It is therefore logical that commercial Fund Managers will seek to invest in the most commercially promising ventures in developing countries.

The UK National Audit Office (2008) found that private equity houses themselves were not convinced of the development gains of the CDC business model. '*Fund managers we interviewed questioned the ability of a 'fund of funds' business to secure the breadth of development benefits that DFID hopes CDC can deliver. They doubted whether higher risk and lower return investments were compatible with a commercial business model*' (2008, p.22). The 'fund of funds' model also brings with it structural challenges for the implementation of the standards included in CDC's Investment Code, given it limited influence on investments made on its behalf:

1. *Devolution of ESG due diligence to Fund Managers*:
   Under the CDC model, competence for assessing risks of non-compliance with the CDC Investment Code, and addressing breaches, is devolved to the 57 commercial Fund Managers in whom CDCs funds are invested. The business logic here is that non-compliance with the Code constitutes an investment risk for the Fund Manager and there is therefore self-interest in mitigating this risk. To support this approach, CDC has developed a Toolkit for Fund Managers.

2. *Leverage and influence*:
   In other areas of development finance, the most obvious means of ensuring improved practices in compliance with investment policies is the 'leverage' afforded by the ultimate sanction of withdrawing funds. It is less obvious how this leverage is brought to bear in the CDC model, whereby funds are already invested in fund managers – for example, in a pool intended for a particular business line – before this fund manager disburses to specific investees. Given that CDC aims to 'catalyse' other (commercial) investment capital – with CDC taking a share on average between 15% - 25% – the challenges for CDC of influencing investee practices are similar to those faced by SRI investors with minority shares. DFID notes that CDC is a long-term investor – typically ten years – and often sits on funds' advisory boards, giving CDC scope to influence improvements across the working practices of investee companies.

3. *Reporting and channels of information*:
   Intermediated finance entails intermediated lines of communication. To date since restructuring, CDC reporting to DFID and the public on compliance with its Investment Code has consisted mainly of examples of good practice in CDC's annual report. NAO (2008) notes, 'r*eporting to DFID by CDC, and to CDC by Fund Managers, on compliance has been highly selective, saying nothing about levels of compliance or trends. Although some Fund Managers provide more comprehensive reporting, most reports lack a clear evidence base or independent verification.'* In October 2008, CDC instituted enhanced arrangements for monitoring business principles, which include a requirement on Fund Managers to report immediately serious breaches or events, and a provision for on-site verification by CDC for high risk investments. DFID confirms that independent verification has now been implemented by CDC, with a number of evaluations conducted by Triple Value, an independent consultancy.

ECGD (Export Credit Guarantee Department)

Whilst not a DFI, nor indeed a 'development' institution, ECGD is considered here since:

- ECGD is a UK Government department commonly involved in private sector projects in developing countries, and
- ECGD applies sustainable development standards to the underwriting facilities it offers which are closely aligned to DFI approaches to environmental and social risk

ECGD is a ministerial department which reports to the Secretary of State for Business, Industry & Skills (BIS) and is responsible for assisting UK exporters by providing financial guarantees and insurance for export contracts in markets where commercial cover would normally not be available.

WHAT DOES ECGD DO?
ECGD offers a number of different types of guarantees and insurance policies ('facilities'), which can broadly be classified into two main groups:
Finance: where a bank (normally in the UK) provides a loan to an overseas borrower in order to finance the purchase of goods or services from a UK exporter. ECGD unconditionally guarantees repayment of the loan.
Insurance: ECGD insures exporters directly against specified causes of losses – for example, buyer insolvency or political risks.

A government review of ECGD in 1999 found that ECGD should also use its leverage to support projects which underpin the Government's international policies to promote sustainable development, human rights and good governance. In this light, ECGD published its Business Principles and developed policies (CIAP - Case Impact Analysis Process) which seek to ensure that environmental and social sustainability considerations are taken into account in deciding whether or not to approve applications for support. In 2003, following recommendations from the parliamentary Environmental Audit Committee, ECGD adopted wording in its application documents which states that it is ECGD's policy not to provide support to projects that involve 'harmful child labour' (the wording used in the World Bank Safeguards) or forced labour'. Under this policy, all applications (with the exception of those under ECGD's recently introduced Letter of Credit Guarantee Scheme) are to be screened against the World Bank Group's Policy relating to 'harmful child and forced labour'.[2]

The only international standards governing sustainability of export credits are those formulated by the OECD Export Credit Agency (ECA) Working Group, for adoption by agencies in OECD member states. A 2007 revision to the OECD 'Common Approaches on the Environment and Officially Supported Export Credits' incorporated reference to labour rights for the first time in any multi-lateral (voluntary) agreement for export credit, by naming the IFC Performance Standards as one of the standards that ECAs could chose to apply to private sector project finance cases '*where*

2 This policy is currently subject to consultation, as part of a broader review of the ECGD Business Principles due to conclude by March 2010. The main proposed change of relevance here is as follows. ECGD has historically assessed projects for sustainability factors – including 'harmful' child and forced labour – where the UK export value is less than SDR 10m (c £10m) or where the repayment term is less than two years. Under the proposed policy statements, it will not now do so unless and until the OECD Common Approaches are revised to include such projects. This has raised civil society concern that this will entail an effective lowering in ECGD's scrutiny of labour standards: www.eca-watch.org/problems/eu_russ/uk/Cornerhouse_ECGD_and_child_labour_jan10.pdf

appropriate'. No definition is given of '*where appropriate*'. The Common Approaches are due for revision again in 2010.

While other ECAs (EKF – Denmark, EDC – Canada) have signed up the 'Equator Principles' – which entail compliance with a broad range of labour rights requirements, see below – ECGD's current position is to incorporate labour risk assessment by reference to ratification of ILO Core Conventions. ECGD indicates that its preference is to pursue 'constructive engagement' with project sponsors so that standards are raised to an acceptable level during the application process, prior to ECGD's decision on whether to grant approval.

Social and environmental impact assessment is only undertaken by ECGD for civil non-aerospace applications, including defence exports not requiring an export licence. ECGD does not apply its procedures for environmental and social risk assessment to civil aerospace applications or to defence exports which require an export licence. In 2007-08, such business accounted for 87% of all facilities issued, by both number and value.

5. Development Finance and Decent Work

The aim of the 'Decent Work Agenda' is to place an explicit emphasis on the welfare of workers while pursuing social as well as economic development. The concept of 'Decent Work' starts from the common sense assumption that development depends on people working. What is at stake in the Decent Work Agenda is *how* work contributes to sustainable development. It is expressly not a question of 'a job at any cost'. Decent Work describes work that is safe, productive and conducted in dignity, with the support of institutions ensuring social protection and the full participation of economic actors, workers and employers alike.

There are therefore several areas of congruence between the objectives of Development Finance Institutions and the broad Decent Work Agenda.

Employment creation

The fundamental premise shared by development finance and the Decent Work Agenda is that employment is at the core of economic and social development. Given the opportunity, poor people can and will work themselves out of poverty. Employment opportunities are critically needed in poor countries that often suffer from chronically high unemployment rates. Therefore, DFIs put considerable emphasis on employment creation when explaining and assessing their role in promoting economic development.

Of course, looking at the employment impacts of DFI activities necessitates a focus on what *sort* of jobs are created and sustained by development finance. The investments which are most financially sustainable are not necessarily those with the optimal employment impact – in terms of creating and supporting jobs where they are most needed, or in targeting labour-intensive activities.

DFIs increasingly recognise the importance of gender in decent work outcomes. For instance, CDC, FMO, Norfund and IFC have commissioned and will soon publish a study outlining how 'gender positive' policies and procedures can be implemented which can also be of benefit to businesses: *Implementing Gender Equality Policies and Practices in Private Sector Companies*.

Building people management skills and capacity

DFIs are in a strong position to help their clients, and SMEs in particular, to see that sound employment practices and respect for workers' rights are core characteristics of a well-run company, and to motivate them to improve their performance in this regard continuously, as a key part of their business strategy. The uptake of good practices resulting in strong company performance can have an important 'demonstration effect' among both peer-group employers and other investors.

In particular, the IFC has pioneered a 'performance-led' approach to labour standards promotion which puts real emphasis on developing systems to enable and ensure compliance with national and international labour standard. In effect, this places labour standards in the context of developing modern and professional systems of HR management, alongside enabling functional systems of industrial relations, rather than approaching compliance solely from the point of view of checkbox-auditing. As such, this approach – which has been pursued by EBRD and many of the European DFIs (EDFIs) – reflects an understanding of developments in private sector supply chain labour standards management.

Investee employers' capacity to communicate with and consult their workers is particularly important where jobs are under threat. It is relevant that many DFIs have adopted policy commitments to 'responsible retrenchment'; this has increasingly become the primary labour issue in many DFI projects over the last year.

Investing in social protection

Social protection is one of the pillars of decent work and an important part of the work of any organisation focused on poverty reduction, including DFIs. 'Social protection' means reducing poverty and vulnerability by promoting efficient labour markets, diminishing people's exposure to risks, and enhancing their capacity to protect themselves against hazards and loss of income.

More technically, social protection is defined by the ILO as the set of public measures that a society provides for its members to protect them against economic and social distress that would be caused by the absence or a substantial reduction of income from work as a result of various contingencies (sickness, maternity, occupational injury, unemployment, invalidity, old age, death of breadwinner); the provision of health care; and, the provision of benefits for families with children.

CASE STUDY: ADB SOCIAL PROTECTION STRATEGY

Under its 'Strategy 2020', the Asian Development Bank's (ADB) supports three complementary development agendas including inclusive growth, which entails the promotion of greater access to opportunities, especially for the disadvantaged. Different social protection schemes are supported by ADB for different target groups:

- labour market policies and programs designed to promote employment, the efficient operation of labour markets and the protection of workers
- social insurance programs to cushion the risks associated with unemployment, ill health, disability, work-related injury and old age
- social assistance and welfare service programs for the most vulnerable groups with no other means of adequate support
- micro-and area-based schemes, including micro-insurance, agricultural insurance, social funds and programs to manage natural disasters / climatic risk
- child protection to ensure the healthy and productive development of children

Source: www.adb.org/SocialProtection

Social protection can be broken down to component parts: labour market policies and programmes; social insurance; social assistance and welfare; micro-schemes to address vulnerability at community level; and child protection. While the first three elements – labour markets, social insurance and social assistance – are often included in social security systems, where they exist, there are many social protection needs which remain unmet. Private sector investment by DFIs can have a role to play in meeting these needs. In particular, through investment in small-scale financial services – such as micro-insurance and savings schemes – DFIs can support financial services which effectively mitigate 'social risk'.

DFIs also recognise that profitable and growing businesses also generate increasing tax revenues that allow low income country governments to fund their own development programmes, through investments in services including social protection.

Implementing labour standards through investment policies and requirements

Increasingly, multilateral and bilateral DFIs require their clients to adhere to national labour laws and international labour standards in their operations. This requirement is encapsulated in various policy statements and standards to which clients are required to adhere, and can also be made a condition of receiving finance. These are re-capped in the table below and addressed in greater detail in section 6.

A key development in DFI commitment to labour rights was the IFC's adoption in 2006 of its Performance Standards. The IFC Performance Standards go beyond the Core Labour Standards to include a series of policy and process requirements, and requires recipients of funding extend labour rights protections to contractor workforces and workers in supply chains to investments.

OVERVIEW OF DFI POLICIES ON LABOUR STANDARDS		
Multilateral DFIs	IFC - International Finance Corporation	IFC Performance Standard 2 (PS2)
	MIGA - Multilateral Investment Guarantee Agency	MIGA Performance Standard 2 (identical to IFC PS2)
Bilateral DFIs	CDC - UK	CDC Investment Code
	DEG - Germany	Guideline for Environment and Social Compatibility (harmonised to IFC PS2)
	FMO - The Netherlands	FMO Environmental & Social Sustainability Policy (harmonised to IFC PS2)
	PROPARCO - France	AFD Policy For Social And Environmental Responsibility
	OPIC – USA	OPIC Investment Policy (*'OPIC cannot provide assistance for any program, project, or activity that contributes to the violation of internationally recognized workers rights'*)
Regional DFIs	EBRD - European Bank for Reconstruction and Development	EBRD Performance Requirement 2
	EIB - European Investment Bank	EIB Environmental and Social Principles and Standards (ILO Core Labour Standards)

Social partner engagement as DFI stakeholders

Whereas certain bilateral institutions, such as the Northern European DFIs, have inherited a governance structure which includes a strong social partner role, in other cases the involvement of social partners as DFI stakeholders has been a relatively recent phenomenon. This is the case with IFC and EBRD, for instance.

In the UK, the TUC has no formal consultative mandate to CDC, except through ongoing dialogue with DFID.

EXAMPLES OF SOCIAL PARTNER INVOLVEMENT BY DFIs	
IFC	• Labour stakeholder group, meets regularly, including Global Unions and representatives of MNEs • IFC online form for unions to report breaches of PS2 in IFC projects (see below)
EBRD	• Labour stakeholder consultation (re Environmental & Social Policy revision 2007/8), including ILO, ITUC, IOE and GUFs
FMO (Netherlands)	• FNV (trade union) Chairwoman sits on FMO Supervisory Board • Minority shareholding (Dutch State holds 51% of shares; Dutch banks 42%; remaining 7% held by employers' associations, trade unions and investors.)
DEG (Germany)	• Supervisory Board includes two senior representatives of DGB (national TU centre), and one each from ver.di (services TU) and NGG (food and agriculture TU)

What does decent work mean for DFIs *operationally*?

The status of Decent Work as an overarching objective makes it more appropriate not as a 'requirement' but as a guiding principle for development finance (understanding that there are components of the Decent Work Agenda which are absolute requirements, namely fundamental rights at work). This guiding principle holds for several aspects of DFIs' and IFIs' operations:

1. To inform the *development mandate* of the institution in question, and in particular any commitment to seek development 'additionality' in investments. Decent Work concerns in development finance investments can usefully be incorporated at the outset of project design, as a means by which to assess the potential development impact of the project. For instance, this may take the form of analysing the labour market impacts of job creation linked to investment – are the jobs durable or temporary, will they draw on the local skills base? – or the capacity of labour authorities, recruitment services, or vocational training providers.

2. To inform the orientation of DFIs and IFIs at the level of *country strategies*. Country strategies can be informed by in-country initiatives to promote decent work; this may entail closer coordination with relevant agencies – such as the ILO, as well as national labour authorities and social partners. For instance, IFC has close links to the ILO, most notably through its global Better Work programme; EBRD also has an MoU with the ILO at global level.

3. To set the context and complement the rationale for the implementation of *investment policies* relating to employment and labour practices. Decent Work does of course contain a vital normative aspect: the *labour standards* component. The provisions of all DFIs and IFIs which promote compliance with the fundamental principles and key regulatory standards embodied in the ILO conventions fully incorporate this pillar of Decent Work.

‘DECENT WORK’ AS A GUIDING PRINCIPLE IN 2008 EBRD ENVIRONMENTAL AND SOCIAL POLICY
“Particular attention will be given to projects which include elements that focus upon priority environmental and social issues facing the region and which promote implementation of relevant EU strategies, such as […] promotion of **decent work**” (EBRD Environmental and Social Policy para 5).
“Country strategies will draw upon the country’s environmental and social strategies and planning (for example […] ILO **Decent Work** Country Programmes)” (EBRD Environmental and Social Policy para 47)
“EBRD will seek to support, though its operations, the initiatives of other institutions such as the ILO and the EU to promote the **decent work agenda**” (PR 2: Labour and Working Conditions, para 2 - objectives)
Source: www.ebrd.com/about/policies/enviro/policy/2008policy.pdf

What are the risks for DFIs in not promoting decent work?

Reputational risk

Perhaps the most direct reason for DFIs to focus attention on decent work is the reputational risk associated with breaches of labour standards in their portfolio companies. Trade unions, as well NGOs, academics and civil society networks – such as the Bretton Woods Project, EURODAD and Bankwatch – are placing increasing scrutiny on DFIs’ and IFIs’ realisation of their commitments to labour standards. Indeed IFC has established a labour stakeholder group in order to ensure that the results of such oversight are conveyed directly to the institution. Further, the link to governments and tax-payers’ money, alongside an express development mandate (in most cases), potentially make DFIs more vulnerable to loss of reputation than private companies.

Credit risk

Financial risks are also increasingly linked to the issue of workers’ rights. Poor employment practices, and dysfunctional industrial relations, can lead to industrial conflict and can sometimes affect production and limit access to high-value markets, and in extreme cases, put the viability of the company in jeopardy.

6. Decent work: implementing policy commitments

In recent years, DFIs have paid increasingly attention to labour concerns in their investments. This reflects both civil society scrutiny and interest, but also the close links between DFIs and the development agendas of national governments and inter-governmental agencies, agendas which are increasingly informed by a decent work perspective.

DFI investment codes and policy commitments on labour standards have evolved from basic provisions on ('harmful') child labour and forced labour to a more comprehensive framework encompassing working conditions, HR management, health and safety and workers' representation and their broadening the scope to include workers in contractor workforces and supply chains to the investment. This development was pioneered by IFC as part of its revision of Safeguard Policies.

IFC

The new IFC Performance Standards on social and environmental sustainability were adopted in 2006; Performance Standard 2 (PS 2) deals with labour issues. The provisions of PS2 are guided by the ILO Core Labour Standards and other labour standards. Importantly, PS2 seeks to emphasise areas which have not always been included in 'codes of labour practice' – in the finance sector or elsewhere – such as measures on responsible retrenchment.

The IFC Performance Standards – including PS2 on labour issues – are currently under review. The process is expected to last until December 2010 and the updated framework to be released by January 2011. IFC has solicited input from ITUC / Global Unions, and will be consulting with stakeholders – including labour stakeholders – on clarity of language, implementation effectiveness, and gaps in the current coverage.

European DFIs (EDFIs)

In 2007, the European Development Financial Institutions (EDFIs) – a grouping which includes CDC[3] – signed the Rome Consensus, which refers to IFC's Performance Standards. In May 2009, this same group signed a declaration on Principles for Sustainable Investing. All the EDFIs agreed to use the IFC Performance Standards as a benchmark for environmental and social review process in all co-financed projects. Some DFIs, such as DEG (Germany) and FMO (Netherlands), also use the IFC Performance Standards for projects financed unilaterally.

EBRD

EBRD has a series of Performance Requirements that include requirements on labour which are very similar, if slightly modified, the IFC PS2. They also include provisions on worker accommodation and greater detail on expectations relating to child and forced labour in supply chains to projects.

3 The CDC Investment Code states that it is 'compatible with' the IFC Performance Standards. The specific provisions of the CDC Code on labour are significantly less detailed than IFC PS2, however, and do not cover several material aspects, such as employment documentation, HR policy, retrenchment, non-employee workers, supply chain and worker grievances.

OVERVIEW OF ISSUES ADDRESSED IN IFC PS2 AND EBRD PR2
Human Resources Policies: Clients must adopt a human resources policy that sets out its approach to managing their workforce consistent with the standards set out below.
Working relationships: Clients must inform their employees about their working conditions and terms of employment
Child labour: Clients are required not to employ children in a manner that is exploitative or is likely to be hazardous or interfere with the child's education (child labour is defined as per ILO conventions 138 and 182)
Forced labour: Clients are required not to use forced labour (ILO definition)
Non-discrimination and equal opportunities: Clients are expected not to make any employment decision on the basis of personal characteristics unrelated to the job requirements. In addition, PR2 requires project to comply with EU requirement on non-discrimination related to employment.
Workers' organisations: Clients should not discourage workers from forming or joining a union or from bargaining collectively. Discrimination or retaliation against workers who participate or seek to participate is prohibited. In addition, both standards require that, in countries where workers' rights are restricted, the client should enable alternative means for workers to express their grievance and protect their rights
Wages, benefits and conditions of work: Wages and benefits and conditions of works should comply with any binding collective bargaining agreement or be comparable to those offered by equivalent employers in the relevant region or sector (EBRD PR2) or be 'reasonable' and at minimum comply with the law (IFC PS2).
Occupational Health and Safety: Clients must provide the workers with a safe and healthy work environment and take the necessary steps to prevent accidents, injury or disease associated with their job. EBRD PR2 uses EC Directives and IFC OHS standards as benchmarks and also includes provisions in relation to accommodation provided by the employers.
Retrenchment: If a significant number of jobs will be lost (see EU definition of 'collective redundancy' for EBRD PR2), the clients must develop and mitigate the adverse impacts of retrenchment in line with national law and good practices. Any retrenchment plan should be based on the principle of non-discrimination.
Grievance mechanisms: The clients must provide a confidential grievance mechanism for workers and their organisations.
Non-employee workers and supply chains: Finally, both PR2 and PS2 include two additional clauses to broaden the implementation of part of their provisions to non-employee workers and supply chain workers. Clients are expected to ensure their non-employee workers benefit from the same standards as their direct employees (excluding human resources policies and retrenchment); and that their suppliers do not use child labour or forced labour.

Equator Principles

A further important development in the private finance sector is the advent of the Equator Principles. The Equator Principles commit signatory institutions ('EPFIs') to apply IFC's Performance Standards when providing project finance or advisory services in emerging markets.

The Equator Principles have become a significant (voluntary) industry framework for addressing social and environmental risks associated with project finance, and have been adopted by 67 financial institutions – for the most part, commercial banks.

DFI APPROACHES TO ENSURING COMPLIANCE WITH LABOUR REQUIREMENTS
Most DFIs have integrated social considerations within all stages of the project cycle, from initial appraisal and categorisation through to monitoring and reporting.
Initial Screening: at the early stage of the project cycle the DFI's social specialists typically 'screen' the project for potential social impacts and risks, and determine what kind of assessment/investigations will be required during the due diligence phase.
Due Diligence: The type of assessment depends on the nature and importance of the potential risks and issues involved, as well as the capacity and commitment of the clients to address those impacts in accordance with the DFI's policy. Projects with diverse and potentially significant social impacts require a comprehensive social impact assessment, to identify and assess the potential future social impacts associated with the proposed project, identify potential improvement opportunities, and recommend any measures needed to avoid, or where avoidance is not possible, minimise and mitigate adverse impacts. Investments into existing companies may require a third-party labour audit if initial information suggests the risk of significant labour non-compliance issues at the facility.
Action Plan: Based on the results of the due diligence, the client develops and implements a programme of mitigation and performance improvement measures and actions that address the identified social impacts.
Contractual commitment / loan covenant: Obligations set out in the DFI policy and the project-specific Action Plan are covenanted into the loan agreement. Breach of these obligations may give rise to default after a grace period.
Monitoring compliance and reporting: Clients are required to monitor, and report to DFIs, compliance with national law and the implementation of the Action Plan alongside the DFI's policy requirements. In addition, where significant issues have been identified during due diligence, DFIs may conduct their own on-site monitoring, or require periodic audits by third-party experts.

Challenges for DFIs in implementing labour policies

Financial institutions adopting labour requirements face considerable challenges in implementing such policies. These challenges include making the standards clear and easily applied to private sector clients; implementing systems for initial evaluation and on-going monitoring and oversight of clients; and training of development finance staff to understand and apply the labour requirements.

IFC – CHALLENGES IN IMPLEMENTING PS2: THREE YEARS ON
"Performance Standard 2 (Labor and Working Conditions) has been broadly applied across regions and sectors, though the requirements have been challenging for some clients, particularly in countries where enforcement of national laws is weak or where such laws do not exist. Requirements on collective bargaining and workers' organizations, as well as supply chain issues have proved to be challenging. The issue of migrant workers, often hired indirectly through contractors, is another area of challenge for clients. Clarifications on working and living conditions of non-employee workers might be needed. Moreover, in a time of economic crisis and shrinking labor market, the role of PS2 in the context of large-scale retrenchment should be considered."
Source: IFC's Policy and Performance Standards on Social and Environmental Sustainability and Policy on Disclosure of Information: Report on the First Three Years of Application, IFC, 2009

Leverage

Once a financial relationship is underway, intervention may be more difficult than before it has begun. It is often necessary to extend the intervention mechanisms beyond requirements of improvement before initial disbursements are made in order to ensure sustained improvements. As noted above, the leverage a DFI has over labour practices in its investment is substantially reduced where investment is made via a financial intermediary (FI), such as a Fund Manager or a bank which on-lends to local clients. A good practice example here is OPIC, which actively monitors and conducts periodic reviews of the funds it supports as well as their portfolio company investments to ensure compliance with OPIC's Investment Policy requirements with respect to environmental guidelines, human and workers' rights.

Significant strides have been made by some DFIs to enable these intermediaries to implement labour standards requirements – amongst others – on behalf of the DFI. These include training the staff of FIs on environmental and social risk assessment and due diligence, as well as providing targeted guidance on the meaningful application of these standards in the local context. Some of these examples of notable practice are summarised below.

DEG DEVELOPMENT INDICATORS FOR PRIVATE EQUITY

DEG (Germany) has developed a series of 'development indicators' for private equity fund managers, including, as 'core development indicators':

- Employment (indirect) at investee companies: Numerical + Qualitative (if necessary) – (i) number of jobs existing and sustained in investee companies, (ii) net employment creation in the year of reporting (if possible by gender & type)
- Compliance with IFI Environmental and Social Standards - A clear statement that the project complies with the specific requirements of the involved IFIs
- Compliance with Core Labour Standards - A clear statement that the project complies with ILO Core Labour Standards and relevant national commitments

FMO GUIDANCE FOR MICRO-FINANCE AND PRIVATE EQUITY ON ESG ISSUES

To enable compliance with its requirements on environmental and social issues – which is based no the IFC Performance Standards – Dutch DFI FMO has developed specialist environmental and social risk management tools for two specific client groups: microfinance institutions and private equity investment funds.

APPLYING STANDARDS THROUGH INTERMEDIARIES: GOOD PRACTICE FROM EBRD

When the EBRD invests via a financial intermediary (FI), the FI must implement the Bank's environmental and social procedures, including all requirements set out in PR2 on labour and working conditions. For many FIs in EBRD's countries of operation, this is the first time that they will have integrated environmental and social considerations into their lending and investment procedures. To help FIs integrate the bank's procedures the EBRD has developed two supporting mechanisms - the environmental and social risk management manual and training programmes. The section of the manual focusing on assessing and managing labour issues includes:

- *Risk assessment on labour issues*: identifying investments with a higher risk of labour rights breaches
- *Assessing labour standards compliance*: clarifying the definition of the labour requirements in EBRD's policy, and the role of national law
- *Mitigating labour rights non-compliance*: clearly stating that FI staff need to carry out investigation in relation to higher risk projects, and to develop systems and resources to do so effectively
- *Sample labour policies for FI clients*: covering core labour standards
- *FI monitoring of labour compliance in investment clients*: EBRD expects that the FI will establish a reporting system from the client to the FI on the effective application of corrective actions / policy
- *Liaison with EBRD on labour issues*: FIs are expected to report to the EBRD on the nature of their screening process for labour issues and to provide examples of remedial actions that have taken place

Building awareness of decent work and labour standards within DFIs

The majority of DFIs have adopted comprehensive institutional policies on labour rights, but now face the challenge of integrating them into their lending practices. Part of this challenge consists of broadening the understanding and engagement of staff with labour standards, and their role in ensuring appropriate labour practices in investments. DFI investment staff require significant training, at a minimum in order to alert specialist colleagues to higher-risk projects which may require more attention to address labour issues as part of the loan.

Competitiveness

The broad coordination between development finance institutions on various 'sustainability' issues reflects a desire to 'take sustainability out of competition', to establish broadly harmonised minimum standards with regard to environmental and social performance. However, there still remains two important challenges for DFIs in this connection:

- to be able to communicate the 'business case' for labour practices consistent with decent work, emphasising amongst others productivity and quality gains, workforce retention, skills enhancement, better capacity to absorb economic shocks, and
- to make the case to a client that their competitiveness will not suffer in comparison to comparable employers in the same sector and / or region which are not subject to the same requirements: in large part this is most effectively addressed by focusing on compliance with national legislation – where adequate – and modernising management systems, wherever feasible and appropriate.

Monitoring project compliance with labour standards

This is a substantial challenge for DFIs. Unlike environmental performance, labour performance cannot be easily quantified and 'measured'. DFIs essentially rely on self-reporting from the client and the following indicators: results of any state labour inspections, advent of labour disputes, and information coming through the client's internal grievance mechanism.

Accountability

DFIs and EPFIs – institutions bound by the Equator Principles – have some public reporting requirements on the application of social and environmental standards in their investments, but there is not yet a comprehensive or fully comparable process. However all DFIs have independent review and complaints procedures, including the IFC's CAO (Compliance and Advice Ombudsman) and EBRD's Independent Recourse Mechanism (IRM).

CASE STUDY: IFC ONLINE COMMUNICATION FORM FOR TRADE UNIONS

Communications about PS 2 violations can go through three channels: the IFC's Environmental and Social Development Department, the IFC Compliance Advisor Ombudsman (CAO), or by contacting Executive Directors of the World Bank (who represent member-country governments). In the large majority of cases, trade unions have gone forward with communications to the IFC Environmental and Social Development Department, which is responsible for overseeing compliance with the Performance Standards.
A pilot website was launched by IFC in January 2009 designed to facilitate effective IFC-trade union engagement on IFC-financed projects, and to systematise and accelerate IFC response to union communications on PS2. It is a part of IFC's effort to further strengthen implementation of PS2 at the local level.

7. Opportunities for Forum members to engage with development finance

Monitoring and oversight of labour rights commitments

DFIs' commitments on labour rights have the potential to be a useful tool to help enforce workers' rights. As ITUC (2009) notes, unions can play an important role in ensuring that DFI clients meet their labour standards obligations. For instance, as of August 2009, unions had registered complaints of labour rights violations, or requested assurances, for 22 proposed IFC investment projects. Global Unions' Washington Office has provided assistance for most of these complaints or communications.

One key question for the Forum to consider is how best DFIs can monitor respect for labour rights in their investments while respecting the primacy of mechanisms of social dialogue, as well as in-company or national labour dispute resolution mechanisms.

ITUC THREE-STEP ADVICE FOR TRADE UNIONS ENGAGING IFC
• Be informed about upcoming IFC projects
• Document the violation
• Contact the IFC using the online communication form
Source: ITUC / Global Unions 'A Brief Guide to Using the IFC Performance Standards'

Advocacy

With the exception of some trade unions, most pressure groups are focused more on environment and the community aspects of development finance, in part because the 'labour agenda' is still relatively new. There are several different areas for potential advocacy. For instance, while the majority of DFIs have adopted comprehensive policies on labour rights, some institutions' policies are less well-developed than the leaders in the field. Further, stakeholders have an important role in advocating for greater resources to be applied to decent work concerns in the DFI project cycle. Civil society and academia, in particular, have an important role to play in ensuring optimal transparency.

Dialogue and communication

Forum members, by definition, have expertise on labour rights and decent work. There is ample scope to improve the level of cross-communication between Forum members and the development finance community. DFI policy formulation is commonly open to stakeholder consultation. Policy reviews are currently underway at IFC and at ECGD (the latter due to end in March 2010): both of these processes are open to expert stakeholder consultation. The OECD 'Common Approaches' for export credit agencies are due to be revised through 2010. In the case of EBRD, all stakeholders are invited to comment on draft country and sector strategies.

8. Conclusion

DFIs are important actors in the Decent Work Agenda. Their investments create and sustain significant number of jobs, and they are committed to ensuring that their investee businesses are run responsibly, in line with national and international labour standards.

Because of the structure of much development finance, which often responds to client demand, there is not always detailed prioritisation of decent work factors – such as the *sort of jobs* created – in project design. To date, much DFI work on 'labour issues' has taken the form of mitigating risks to a project which is already fully or mostly formed. This largely reflects the recent history of DFI sustainability commitments, whereby labour concerns were incorporated into existing environmental 'due diligence' procedures. DFIs can fruitfully give greater and earlier attention to decent work factors – both to improve development outcomes, and to facilitate subsequent compliance with their labour standards requirements.

DFIs are required by their shareholders to take equity in poorer, higher risk, countries and sectors, to grow markets and improve the investment climate, and to demonstrate positive investment experiences. They are also required to mobilise private capital, price products to generate commercial returns and build companies able to attract private capital in the future.

As ODI notes, this series of objectives poses a significant potential conundrum for DFIs: it may not always be possible concurrently to secure commercial rates of return (achieve 'financial sustainability'), mobilise additional private investment (act as a 'catalyst') *and* move into areas where the private sector prefers not to go while ensuring responsible competitiveness (achieve 'additionality' and 'development impact').

This conundrum is of particular relevance to this paper. In its submission of the DFID 2009 White Paper, the Bretton Woods Project argues – in relation to IFC – that DFIs '*must demonstrate that [they are] adding value above what normal private sector finance can deliver. That means looking more closely as measures of value-added, including by incorporating measures of human development and environmental sustainability*.' This paper suggests that decent work promotion describes one of the central – and feasible – ways in which DFIs can improve and demonstrate their development impact, and thus the fulfilment of their mandate: financing development.

Annex 1: Glossary

Actis	Actis is a private equity fund-managing company which was formed in 2004 by a CDC management buy-out
ADB	Asian Development Bank
AFDB	African Development Bank
CDC Group	Formerly Commonwealth Development Corporation, CDC is a UK government-owned 'fund of funds' which invests in private equity funds focused on 'emerging markets', with particular emphasis on South Asia and sub-Saharan Africa. CDC does not invest directly in companies, but rather invests capital with fund managers
COFIDES	Compania Espanola de Financiacion del Desarrollo (Spain)
Debt finance	Loan finance
DEG	Deutsche Investitions und Entwicklungsgesellschaft (Germany)
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
ECGD	UK Export Credit Guarantee Department – provider of Government-backed guarantees, insurance and re-insurance to UK exporters against the risk of non-payment, when this support is unavailable from the commercial market
EDFIs	European Development Financial Institutions
EIB	European Investment Bank
EPFIs	Equator Principles Financial Institutions
EPs	Equator Principles
Equity participation	Finance by buying company shares
Export Credit Guarantee / Insurance	Export Credit services, such as those provided by ECGD, cover contracts involving the export of capital equipment and project-related goods and services, in the following ways: • insuring export contracts for the supply of capital goods and services against non-payment by overseas buyers • providing loan guarantees to financial institutions so that they can finance exports (ie make loans available to overseas buyers to purchase goods and services from UK-based companies) • insuring investments in overseas projects (eg against political risks)
FINNFUND	Finnish Industrial Development Fund
FMO	Netherlands Development Finance Company
Guarantees	A type of insurance to mitigate investment risk
IDB	Inter-American Development Bank
IFC	International Finance Corporation (private sector arm of World Bank Group)
IFU	Industrialiseringsfonden for Udviklingslandene (Industrialisation Fund for Developing Countries, Denmark)
MIGA	Multilateral Investment Guarantee Agency
NORFUND	Norwegian Investment Fund for Developing Countries
OPIC	Overseas Private Investment Corporation (US)
Project Finance	Financing of long-term infrastructure and industrial projects using project debt and equity, involving a number of equity investors ('sponsors') as well as a syndicate of banks that provide loans to the operation
Quasi-equity	Financial products which combine equity and debt features

Annex 2: Log of Trade Union Complaints Filed with IFC related to non-compliance with policy commitments set out in PS2

DATE OF CONTACT	COUNTRY	COMPANY & IFC PROJECT NO.	SECTOR	ORIGIN OF COMPLAINT	NATURE OF COMPLAINT	OUTCOME
June 2004	Haiti	Grupo M #20744	Garment	Haitian union *	FoA: 300 workers dismissed for striking for union recognition.	Workers re-hired, union recognized, CBA concluded
July 2006	Brazil	GOL airlines #24609	Transport	ITF	FoA: anti-union action & age discrimination regarding cabin crews.	Company corrects some anti-union action; the union chooses not to pursue discrimination charge.
Nov. 2006	Belarus	Detroit Investments #25113	Food & Beverage (Agribusiness)	IUF & ITUC **	FoA: general anti-union repression in Belarus.	IFC does not accept union request to reject project financing, but does include additional project monitoring & training programme on FoA.
Jan. 2007	Bulgaria, Croatia, & Poland	Schwarz Group #22328	Retail	Ver.di (Germany) †	Company record of lack of social dialogue.	Improvements of local human resources management, including grievance mechanisms, electronic working time registration.
Jan. 2007	Africa Region	CelTel #25514	Telecom	UNITelecom	Child labour: use of child street vendors to sell phone cards.	IFC claims employer is monitoring situation, invites documentation of violations. No other follow-up.
Mar. 2007	Pakistan	KESC #25396	Electric Power	APTUC & ITUC	FoA: employer refuses to recognize union as CB agent.	IFC supports employer's stance that union must reregister, despite legal obstacles.
May 2007	Uganda	Bujagali #24408	Hydropower construction	BWI	FoA: subcontractors resisting unionization.	IFC intervenes, obstacles to unionization lifted, contractors abide by industry CBA.
Nov. 2007	Belarus	A1 #26253	Retail	ITUC	FoA: general antiunion repression in Belarus.	IFC does not accept union request to reject project financing, but does include additional project monitoring & training programme on FoA.
Nov. 2007	Indonesia	Wilmar #25532	Agribusiness	ITUC	Forced labour in supply chain (palm oil supplier).	IFC investigates & determines the supplier no longer used.
2008	Turkey	Sarten #25740	Production (tin cans, plastic containers)	Türkis †	FoA issues.	Project is active but no information about outcome.
2008	Turkey	Unitim #25832	Textiles, Apparel	Türkis †	FoA issues.	Company in bankruptcy
2008	Turkey	Atateks #26376	Textiles, Apparel	Türkis †	FoA issues.	Company in bankruptcy

Jan. 2008	Bangladesh	Kazi-Poultry (N/A)	Agribusiness	ITUC	Warnings about local conditions concerning bird flu, child labour, FoA.	Proposed investment is not pursued.
May 2008	Jordan	Disi Water #26620	Infrastructure	AFL-CIO	FoA: no rights for migrant workers and other issues.	Project is suspended.
Apr. 2008	Nigeria	Ecobank #26872	Finance	UNIFinance	FoA: various incidents of anti-union action.	IFC adopts new procedures to monitor projects of "financial intermediary" (FI) status; company changes practices.
July 2008	Colombia	Avianca #25899	Transport	ITF	FoA: discrimination against union activists in job assignments.	Investigation is carried out, results pending.
Sept. 2008	Bulgaria, Romania	Soravia Real Estate #26132	Real Estate	BWI	Request for information about project	IFC responds and provides requested information.
Sept. 2008	Panamá	La Autoridad del Canal de Panamá #26665	Infrastructure	AFL-CIO & ITUC	Question about which labour code has jurisdiction over project.	IFC verifies jurisdictional status of project.
Sept. 2008	Turkey	Standard Profil #26098	Oil & gas	Türkis & ICEM ††	FoA: problems in recognition of trade union representative by employer.	Union agrees with IFC programme for training of management and union on FoA.
Oct. 2008	Turkey	Assan Aluminyum #26648	Manufacturin g	Türkis ††	FoA: problem of union recognition in privatized firm.	Union agrees with IFC programme for training of management and union on FoA
Feb. 2009	Guatemala	GyT #26634	Finance	Local organization	FoA in finance sector.	Outcome pending.
Aug. 2009	DRC	Millicom #28033	Telecom	UNITelecom	FoA: hostile stance towards union; inadequate consultation regarding planned retrenchment; child labour in supply chain.	Outcome pending.

Source: ITUC / Global Unions Washington Office

* The Grupo M investment (Haiti) is considered a pre-PS 2 "test case" because IFC accepted to include a labour rights requirement in the loan contract at the suggestion of ITUC and ITGLWF.** The Detroit Investments case (Belarus) was also presented to World Bank Executive Directors representing EU countries.† Cases not submitted with assistance of ITUC/Global Unions Washington Office.†† Cases submitted by the union through the Compliance Advisor Ombudsman (CAO).

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