

# BLENDED FINANCE: FINDING ITS RIGHT PLACE

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This paper deals with the questions *Where, for what* and *when* should blended finance be used and promoted? It does so in a manner that lends support to the argument that more attention should be given to the mobilisation of public resources – domestic as well as international (ODA). Leveraged private capital is important but cannot and should not play the most important role in financing the SDGs in developing countries – in particular the core social SDGs.

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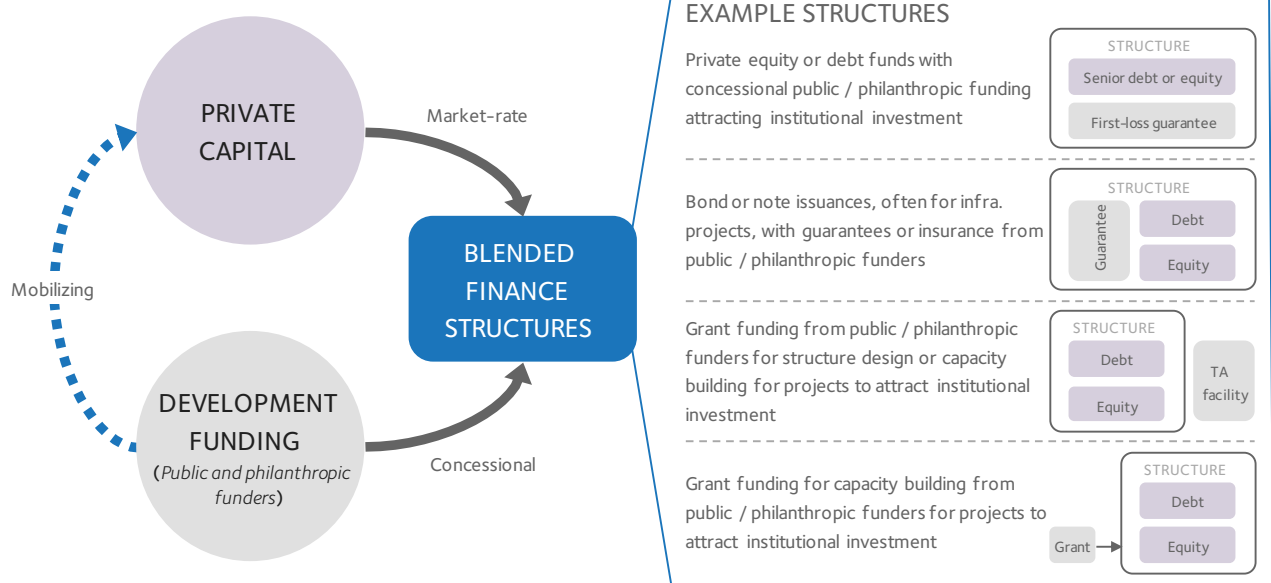
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# INTRODUCTION

The use of development capital to attract private capital is a tool with a long history. However, during the past five years or so, the role of private finance has dominated the development discourse. To a large extent the debate concerns blended finance – the use of

development finance to mobilise commercial finance towards sustainable development through e.g. concessional loans or guarantees.<sup>1</sup> Development finance institutions (DFIs) used to be the main vehicle, whereas now new modalities are used (see picture 1).

PICTURE 1 - WHAT IS BLENDING?



In blended finance, concessional development funding is used to mobilise private capital for investments with a positive development impact. A number of modalities can be used, such as guarantees, equity or grants.

Source: Convergence.

The debate tends to be polarised. Proponents of blended finance have voiced great expectations. They argue that private investments, leveraged through blended finance, are necessary to close a huge financing gap of 2.5 trillion USD annually needed to meet the Sustainable Development goals (SDGs). Official Development Assistance (ODA) is many times smaller, and hence should be used in a catalytic way to mobilise, or *crowd in*, lots of private money. “Billions to trillions”, is the short narrative.<sup>2</sup>

Many NGOs, on the other hand, are sceptical and see blended finance, together with Private Public Partnerships (PPP), as expressions of a general “corporate capture” of development. They emphasise that ODA is a unique resource in that it can potentially be devoted in whole to the core Agenda 2030 goals of poverty elimination, reduction of inequality and leaving no one behind. Blending could *crowd out* ODA investments for these purposes, it increases the incentives to tie aid, and the development impact is yet to be proven, it is argued. In short: blending could be a waste of resources that might end up subsidising private finance, with a high opportunity cost.<sup>3</sup>

In addition there are less polarised and often more technical discussions around questions on how blended finance should be implemented.<sup>4</sup> Lately, the imperative to demonstrate development impact has been emphasised in the debate. While initiatives to create common frameworks for assessing and monitoring impact are taken, there is still little evidence of impact.<sup>5</sup> A recent assessment of available evidence on impact shows how the translation of investments to impact on poverty is dependent on a number of implicit assumptions. The number of jobs created will, for example have different impact on poverty if the jobs are decent or not, if women or men are employed, and the degree to which marginalised people are able to access them.<sup>6</sup>

## WHEN, WHERE, FOR WHAT - AND HOW - TO BLEND?

The overall picture is that finance for sustainable development falls far behind.<sup>7</sup> Hence, all financial sources should be scaled up, whenever possible and appropriate. Our first set of questions, I suggest, should be: *Where, for what and when* should blending be the preferred financing model? In which sectors and contexts are the potential benefits of blending largest? In which contexts do we see risks of negative effects on markets or public objectives such as respect for human rights or policy goals to increase equality? For shortness I will refer to these as the “where-questions”.

In principle, the alternatives to blended finance are various forms of either public or private finance. In many cases, private or blended finance is not a possible or appropriate manner to enable investments in public goods and other issues of public interest. Whenever that is the case, public finance should be sought instead.

### ACTORS AND PROCESSES TO PROMOTE BLENDED FINANCE – SOME EXAMPLES

- **OECD** produces research, arranges conferences and has been coordinating efforts to establish and implement good practice principles for blended finance. The OECD DAC **Blended Finance Principles** were approved at the DAC High Level Meeting in October 2017 and work has since been undertaken to turn the principles into action. <http://www.oecd.org/development/financing-sustainable-development/development-finance-topics/blended-finance.htm>
- The Business and Sustainable Development Commission, related to **World Economic Forum (WEF)**, has convened a **Task Force on Blended Finance** which delivered its report and a programme of action in 2018. <https://www.blendedfinance.earth/>
- The **DFI Working Group on Blended Concessional Finance for Private Sector Projects** presented **enhanced principles and guidelines** in 2017. European DFIs are coordinated through the **European Development Finance Institutions (EDFI)**.
- Blended Finance has been a major theme at e.g. **UN Finance for Development Forum**, UNGA summit 2018, and **WB/IMF annual meetings** and spring meetings.
- **Convergence** is a global network for blended finance which was conceived under the WEF and the OECD-DAC’s ReDesigning Development Finance Initiative and is funded by the Government of Canada. <https://www.convergence.finance/>
- In October 2018 at the IMF and WB Annual Meetings in Bali, the **Tri Hita Karana Roadmap** was adopted. It sets out a shared value system – bringing together the DAC principles and the DFIs principles – and identifies five key areas for action. This was supported by the Government of Indonesia and the OECD, as well as other bilateral and multilateral organisations, including Convergence, Swedish Sida and the WEF. The focus is now on developing concrete guidelines for implementation of the action areas.
- **The Global Impact Investing Network (GIIN)** established a Blended Finance Working Group in 2017. <https://thegiin.org/>

The *how*-questions are crucial – in the contexts where blending is suitable, how can it be implemented and scaled up in a manner that maximises development impact and honours important principles of transparency, respect for human rights, etc? As reflected in the OECD DAC Blended Finance Principles, there is today broad agreement that blended finance should adhere to the same standards as other development cooperation, including the four key development effectiveness principles to which all donors subscribe – country ownership, inclusive partnerships, country driven development results, and transparency and accountability.<sup>8</sup> The key issue

is to make sure these commitments are put into practice.<sup>9</sup> This paper, however, deals with the first set of questions: *Where, for what and when should blending be used and promoted?* It does so in a manner that lends support to the argument that *more attention should be given to the mobilisation of public resources* – domestic as well as international (ODA). Leveraged private capital is important but cannot and should not play the most important role in financing all the SDGs in developing countries. Public finance must play a major role in financing the core social SDGs, in particular SDG 3 and 4 on health and education.

### BLENDING FINANCE AND PPP

Blended finance and Private Public Partnerships (PPP) are two ways through which private influence and responsibility increase in areas generally seen as public. As such, the concepts are sometimes confused. In simple words, blended finance has to do with how an investment is financed, and therefore the inherent profitability of an investment. PPP on the other hand, has to do with how and by whom an investment is implemented. The alternative to blended finance is either public or private finance. The alternative to PPP, on the other hand, is public procurement. In practice, an investment could involve either PPP, blending or both at the same time.

PPP means long term close cooperation between the public and private entity in the supply of assets and services traditionally provided by government, such as hospitals, schools, prisons, roads, energy, etc. It is a medium- or long-term contractual arrangement including risk, income and responsibility sharing. In the end, however, the responsibility is public since PPP are used for projects that are considered part of the public responsibility. The services that the private actor deliver through a PPP is eventually paid by either public authorities, or by users through user fees that are regulated by the public authorities.

The “P” for “private” is often assumed to be big (and often foreign) companies. However, there are many different forms of

PPP, and the private entity can be e.g. small and medium enterprises, (although challenging\*) and faith-based organisations\*\*.

The main advantages of PPP are that governments do not have to pay upfront investment costs, and that they get access to know-how in managing the project/investment. The disadvantage is that PPP are often much more expensive in the long run, since governments generally pay lower interest on loans than private companies. In addition, the fact that the public authority has less control of the project can turn out to be problematic, as is the fact that the public sector often does not have the necessary capacity to negotiate, implement and monitor a project in the public interest.\*\*\*

\* <https://ppp.worldbank.org/public-private-partnership/small-and-medium-enterprises-and-ppps>

\*\*Josephine Sundqvist (2018), “Beyond an Instrumental Approach to Religion and Development – Challenges for Church-Based Healthcare in Tanzania”. *EBA Dissertation Brief Series 2018:01*.

\*\*\* IMF Fiscal Affairs Department (2018), *How to Control the Fiscal Costs of Public-Private Partnerships*; Eurodad (2018), *History RePPPeated – How public private partnerships are failing*.

# IN SEARCH OF CHARACTERISTICS OF USEFUL SUBSIDIES

Little attention is paid to “*where and when*”-questions in the OECD Blended Finance Principles.<sup>10</sup> The same is true for the principles developed by the DFI Working Group on Blended Concessional Finance for Private Sector Projects.<sup>11</sup>

In a recent report from Convergence<sup>12</sup> it is noted that “blended finance can only address a subset of SDGs that are investable”. The main role of blended finance is suggested to be in “stretching scarce resources for: i) development interventions with a proven track record, ii) private sector development interventions (e.g., microfinance, SME finance), and iii) transitioning and graduating countries across income levels”.

ODI sees the potential for blended finance in “helping to pioneer and create new markets, foster innovation and invest at the earliest stages of projects, when risk levels are at their highest and when private investors need a greater risk mitigation”.<sup>13</sup>

## WHEN CONCESSIONALITY IS NEEDED

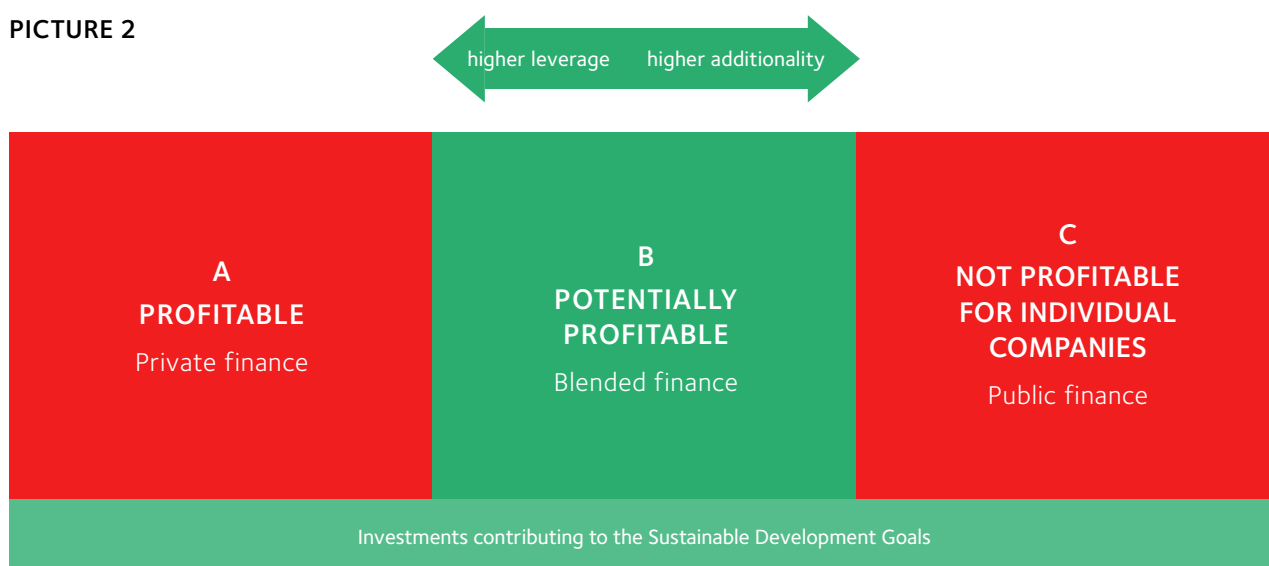
In the following, I offer a few ideas to further the discussion regarding where the right place is for blended

finance. Area B in picture 2 is the right place for blended finance. In identifying this area, a distinction must first be made between investments that would have taken place anyway (area A), and those that need some kind of subsidy to be realised (area B). Several of the blended finance principles mentioned above deal with this distinction.

A second distinction is the one between investments that are potentially profitable for individual companies (area B) and those that are not (area C). For example, investments in human capital, such as health and education for people living in poverty, do not reap any immediate commercial returns. They do, however, enable a healthy and educated population that is important for other companies and society at large. Most countries, North or South, use public resources to finance universal health care and education (area C). The same logic should apply in the discussion on blended finance.

This second distinction is not discussed a lot in the literature on blended finance, but Convergence explicitly mentions: *Blended finance can be leveraged where the recipient of the funding can generate cashflows to repay/remunerate the funding.*

PICTURE 2



*The relevance of blended finance is depending on whether the investments are profitable, potentially profitable or not profitable for a commercial investor.*

## KEY CONCEPTS: ADDITIONALITY AND LEVERAGE

Picture 2 also indicates additionality and leverage, two crucial aspects of blending that are often discussed. Although they are very difficult to measure in practice, they tend to decrease or increase the more you move to the left and right in the figure.

Financial additionality is generally understood as the degree to which blending is necessary to ensure the project gets finance and can be implemented. In the absence of financial additionality, the blending project is receiving a subsidy or other benefit that is not necessary for it to go ahead. This will distort the market and can crowd out other investors.

Developmental additionality, on the other hand, means blended finance helps the project achieve better development results – through the provision of technical assistance, for example.<sup>14,15</sup> In picture 2, this would mean that blending could be relevant and improve development impact in both area A and B. Another way of improving development impact in area A is to implement legal requirements that apply to all companies.

Another important concept in blended finance is ‘leverage’ and ‘leverage ratios’. A leverage ratio can be defined as the relationship between the amount of commercial finance mobilised and the amount of development finance that has been injected.<sup>16</sup> The more private capital that is attracted through a guarantee or other blending facility, the higher the leverage. A leverage ratio 2 would mean that for each euro in development finance, two euros in commercial investment would be mobilised. There are sometimes claims that leverage ratios can be very high – seven is recently mentioned as an illustrative example.<sup>17</sup> In practice, however, the ratio tend to

be more modest, especially in more difficult contexts. A recent ODI study found that the leverage ratios tend to be lower than 1. Thus, “billions to billions is more plausible than billions to trillions”.<sup>18</sup> It should be noted that low leverage ratios may not necessarily be a bad thing – high leverage ratios may in fact indicate low hanging fruits and unnecessary subsidies.

The arrows in picture 2 indicate a typical trade-off between the two aspects: the higher the leverage ratio, the lower the financial additionality tend to be. If very little concessional finance is needed to attract a lot of private finance, the higher is the probability that the investment could have happened anyway, that is, financial additionality is lower.<sup>19</sup>

The evidence of low leverage ratios points to the conclusion that mobilisation targets should be avoided, since a strong emphasis on high leverage and quantitative targets may shift emphasis away from ensuring financial additionality and prioritising development impact.<sup>20</sup> In our picture it is assumed that all investments have a positive development impact and contribute to SDGs, although there may in fact exist a trade-off<sup>21</sup> between financial returns and impact. As regards area A, the assumed development impact is in line with the recent ambition of OECD to go from a “billions to trillions” to a “shifting the trillions” narrative, and is contingent on stricter regulations.<sup>22</sup> In addition to stricter regulations that apply to all businesses and society at large, all investments that are publicly supported need to follow particular high standards in order to be transformative – whether financed via blended finance or ODA grants. The point here is that development impact has to be carefully regulated and monitored, regardless of financing mechanism.

### EXAMPLES OF BLENDED FINANCE PROVIDERS

- The European Commission launched the European Investment Plan in 2017 that includes the **European Fund for Sustainable Development (EFSD)** expected to leverage €44 billion of investment through an initial EU ODA input of €4.1 billion for blending and a guarantee fund. A significantly larger **EFSD+** with a new **External Action Guarantee** is currently (2020) negotiated as a major element of EU future instruments for development cooperation.
- The World Bank adopted the “cascade” approach that intended to **Maximise Finance for Development (MFD)** by prioritising private solutions wherever possible (2017).
- The **International Finance Corporation (IFC)** is the private sector institution of the World Bank Group. Of the 13 billion paid-in capital increase to the World Bank Group in 2018, there was a strong focus on IFC – earlier a marginal part of the World Bank Group.
- The **Green Climate Fund** opened a Private Sector Facility (PSF) in 2017.
- Examples of active bilateral actors: **USAID** (USA), **DFID** (UK), **BMZ** (Germany), **Dutch Growth Fund** and **FMO** (the Netherlands), **Sida** (Sweden).



## THE GREY ZONES OF REALITY

The real world is full of grey zones rather than clear-cut distinctions between the three areas, as shown in picture 3. The question, then, is: How do we know whether a specific project/investment fits in the first, second or third category and thus is suitable for blending? What kind of questions do we need to answer in a specific context?

The left grey/fuzzy area is a purely economic or technical issue, one that all development practitioners involved in blending are dealing with on a daily basis. What level of concessionality is needed to get the investment going?<sup>23</sup> If too large concessionality is given, there is a risk for over-subsidisation, and crowding out other private investors. The cost of such a market distortion may be very high, as exemplified in a recent paper.<sup>24</sup>

In practice this question is very difficult (if not impossible) to answer, given the information asymmetry where it is not in the private company's interest to reveal their real financial risks.<sup>25</sup>

It should be noted that DFIs and national development banks will operate in the left part of the grey zone between area A and B, since they are mandated to be profitable, but have lower expectations on rate of returns than private investors ("soft blending", it has been suggested<sup>26</sup>).

Defining the grey zone on the right hand side, however, is both an economic and a value based, political issue. The technical/economic question is simple: Is the investment potentially profitable?

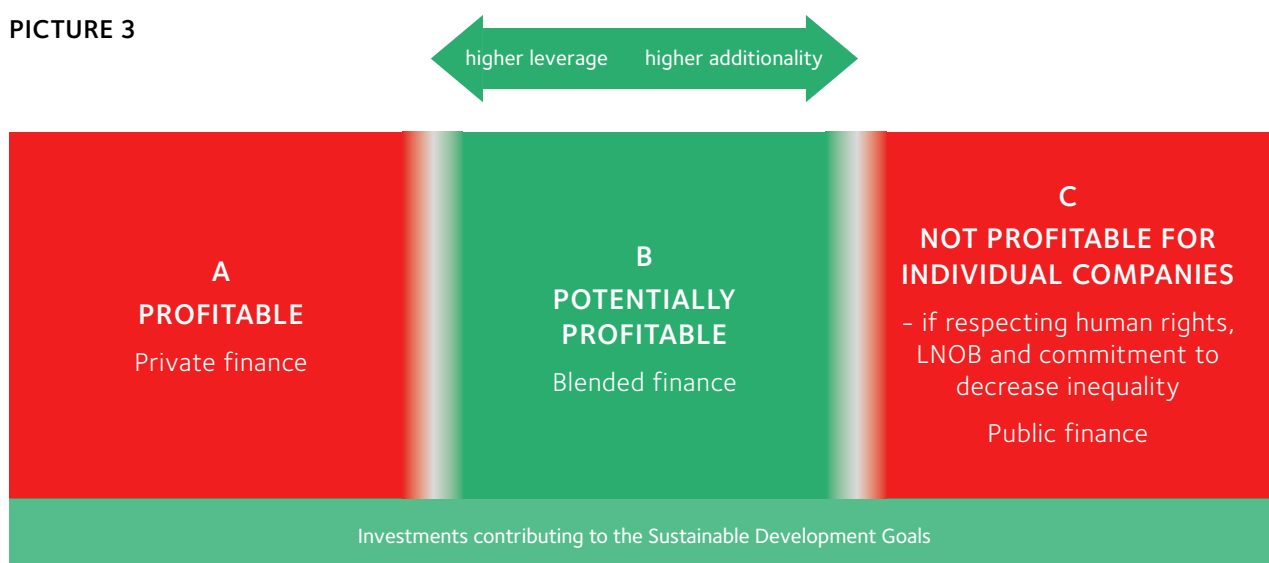
If not, it will be impossible or very costly to attract private capital, and there is an inherent need for public investment.

The political question is more complex and concerns commercial investments that are *possible* to make, but perhaps not *appropriate*. It is a question of political choice, but also intimately linked to existing norms such as human rights, mitigating and adapting to climate change, as well as the commitment to decrease inequality and leave no one behind (LNOB).<sup>27</sup>

The general question is: *Does the financing model of a specific investment supported through blended finance influence the investment's ability to contribute to SDGs and honour the commitment to LNOB?* It can be analysed through more specific questions such as:

- What is the impact of the investment on the national health and education systems, and thereby on the human rights to health and education?
- Who will benefit from the investment? Will the investment lead to better access for poor and marginalised communities? Or is public investment necessary to guarantee the level of access needed to honour the commitment to LNOB?
- Does the investment primarily benefit the domestic private sector in partner countries – in particular SMEs – or donor country based companies? (If the latter – grant based support of the local investment climate is an option that should be considered).

PICTURE 3



In reality, the distinction between situations where private, public or blended finance is preferable is not clear-cut. Identifying situations where public or blended finance is appropriate involves technical as well as political considerations.

- Is the impact on land rights, labour rights, gender equality, and environment etc., influenced by the financing model? If so, how?
- Is the possibility to hold the investors accountable influenced by the financing model?
- Do the investments align with national development priorities and are they transparent enough to be monitored by public authorities?
- What regulatory framework, or continuous public finance, needs to be in place for the investment to contribute to the commitment to LNOB?

Failure to consider these kinds of questions could seriously invoke scepticism within civil society groups and other stakeholders towards blended finance as a resource for Agenda 2030.

In practice, the question whether blending is appropriate or not is always considered before a blending initiative is taken, implicitly or not. By making this consideration explicit, and pointing at its normative nature, the political nature of the question is highlighted and thus cannot be hidden in technical or operational decisions. Such transparency will, I believe, enable more inclusive and better decision making processes.

Explicitly considering whether blending is likely to be appropriate in a particular case will have consequences for the practical promotion of blending. For instance, the World Bank “cascading approach” to Maximise Finance for Development<sup>28</sup>, in which private finance

is always the first choice, would have to be adjusted. At present it includes a possibility test, but does not consider appropriateness.

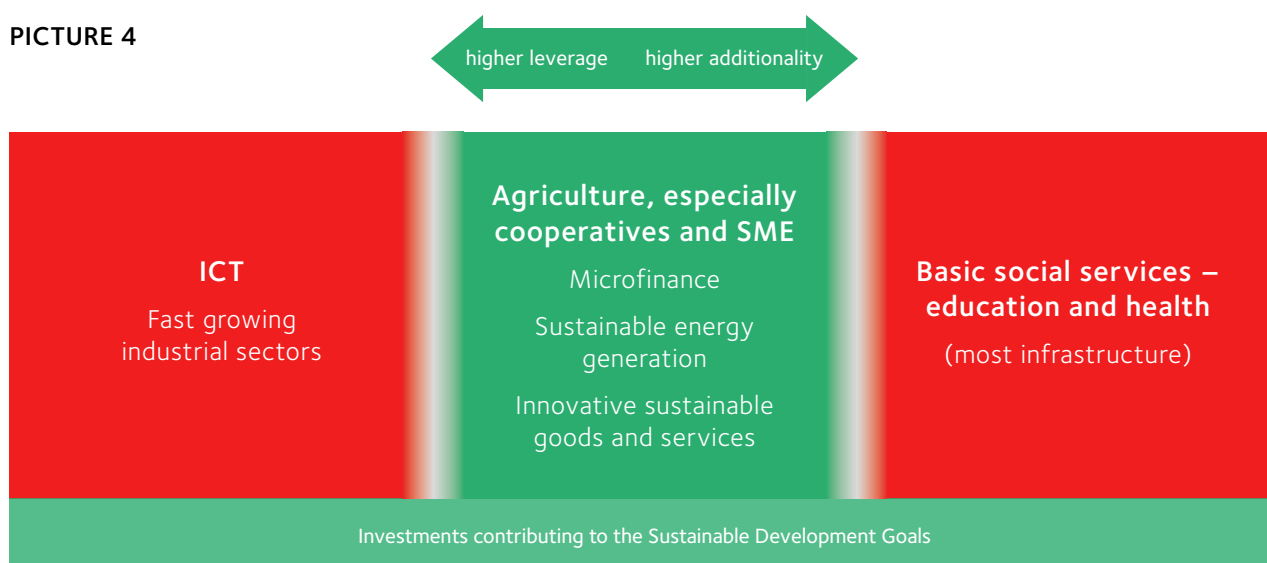
Neither of the grey zones are static, and they will vary over time, development purpose and geographical contexts, depending on the perceived risks and other aspects of the situation: local financial markets, regulatory frameworks and political choices, etc. For example, in least developed markets where financial risks are higher, more industrial sectors will be “potentially profitable”, rather than “profitable” and higher concessions needed. As renewable energy technologies are commercialised, they will move from area B to area A. This underlines the fact that blending facilities should include clear exit strategies.<sup>29</sup>

### SECTORS LIKELY TO BE SUITABLE FOR BLENDING – AND NOT

A crude attempt to identify sectors for which blending is likely to be appropriate or not is shown in picture 4. Simply put, health, education and other basic social services are put in the public finance area<sup>30</sup>, whereas investments in agricultural development, especially cooperatives and SMEs, and sustainable energy and a number of other sustainable goods and services are good candidates for blending.<sup>31</sup>

As a reference, Sustainable Development Solutions Network (SDSN) suggest the following examples of areas where public finance are needed and private, for-profit financing is intrinsically insufficient or impossible: helping the poor to meet basic needs (as the

PICTURE 4



Examples of sectors where private, public or blended finance is likely to be appropriate to finance investments.

poor lack purchasing power), networked infrastructure (natural monopolies or infrastructure that allow for only very limited competition), climate adaptation, and public goods such as post-conflict assistance and peace-building, the preservation of biodiversity and ecosystem services, and the promotion of innovations in sustainable technologies.<sup>32</sup>

Given the fact that the choice between blending and public is political, I do not suggest that the sectors put in area C should be definitely excluded, but rather, that blended investments in social sectors should be extra carefully assessed – to what extent do they promote or hamper LNOB and equality, not only on a project level, but also from a systems perspective. At a minimum, providers of development finance should not push for privatisation and blending in those sectors.

Putting “most infrastructure” in the area for public investment may be the most controversial suggestion, given the strong focus and expectations on infrastructure in the push for blending.<sup>33</sup> There are good reasons for why infrastructure investments, historically and globally, have been dominated by public finance and continue to be so. Infrastructure investments are very long term and typically involve positive externalities or public goods, which makes them highly risky for private investors.<sup>34</sup>

Private investments in infrastructure is currently actively promoted by a number of International Finance

Institutions, but it should be noted that in reality the private investments in infrastructure in LIC has collapsed from 3 billion USD in 2012 to 300 million USD in 2016.<sup>35</sup>

The debate on the role of private finance in infrastructure investments will continue, especially regarding the proposal to create a special “asset class”.<sup>36</sup> It should be noted that this discussion is by no means a “developing country issue” – it is debated in most countries.<sup>37</sup>

More attention should be given to the “how issues” that will determine the degree to which blending in e.g. the agriculture sector, and other sectors where blending is appropriate, render good development impact in practice. The major challenge, however, is to scale up investments in projects that are identified as having high impact on sustainable development. An important obstacle is that current business models of development finance institutions do not allow them to take on the risks (or the rate of returns) that are necessary.<sup>38</sup>

## IMPLICATIONS FROM A BRIEF REALITY TEST

In reality, we can see that blending is concentrated to a few sectors: the financial sectors, energy, industry/mining/construction and non-energy infrastructure (mostly telecommunications, transportation and water), leaving several SDGs with small or hardly any private investments.<sup>39</sup> The general picture is that LMIC manage to attract quite a lot of blended finance, whereas very

### HOW BIG IS BLENDED FINANCE – WHAT DOES THE DATA SAY?

The lack of common definitions and conceptual frameworks makes it difficult to assess the growth of ODA money used for blended finance, as well as the amount of commercial resources that have been mobilised.

**Mobilisation data:** Estimates of private finance mobilised through blended finance by MDBs, DFIs and donors in LICs and MICs range from \$3.3 billion to \$27 billion annually. This rises to \$71.1 billion if we use total direct and indirect mobilisation reported by MDBs.

**Development finance injected:** There are no publicly available data on the grant equivalents (subsidies) provided by development finance institutions. In its calculations ODI focus instead on the ratio of public investment (as proxied by MDB and DFI own-account commitments) to private finance mobilised. The assessments of own-account commitments varies between \$2.2 billion and \$12.1 billion annually, reflecting the different scopes of the surveys. Estimates of the amount

of development finance that is used to mobilise commercial resources are needed to assess the leverage ratio – and the risk that blending arrangements will crowd out grant ODA for other purposes.

**Geographical distribution:** In terms of aggregate capital flows as well as number of deals, lower-middle income countries constitute about half of the committed capital. Upper-middle income countries and low income countries about 25% each.

**Size of deals:** Blended finance deals range in size from less than \$5 million to over \$1 billion, with a median deal size of \$56 million.

References: “Amounts mobilised from the private sector by development finance interventions. OECD mobilisation Data, June 2019”; Convergence (2018), *The State of Blended Finance*; Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI.

little go to LDCs.<sup>40</sup> In general, the mobilisation of private finance through blended finance is growing substantially slower than anticipated.

Hence, picture 4 is not very far from the current status of blending. You could draw different conclusions from this fact. You could, as the OECD does in the report *Making Blended Finance Work for the Sustainable Development Goals*, suggest that we should try even harder and find new ways to mobilise private capital to those sectors and geographical contexts where blending is least common today:

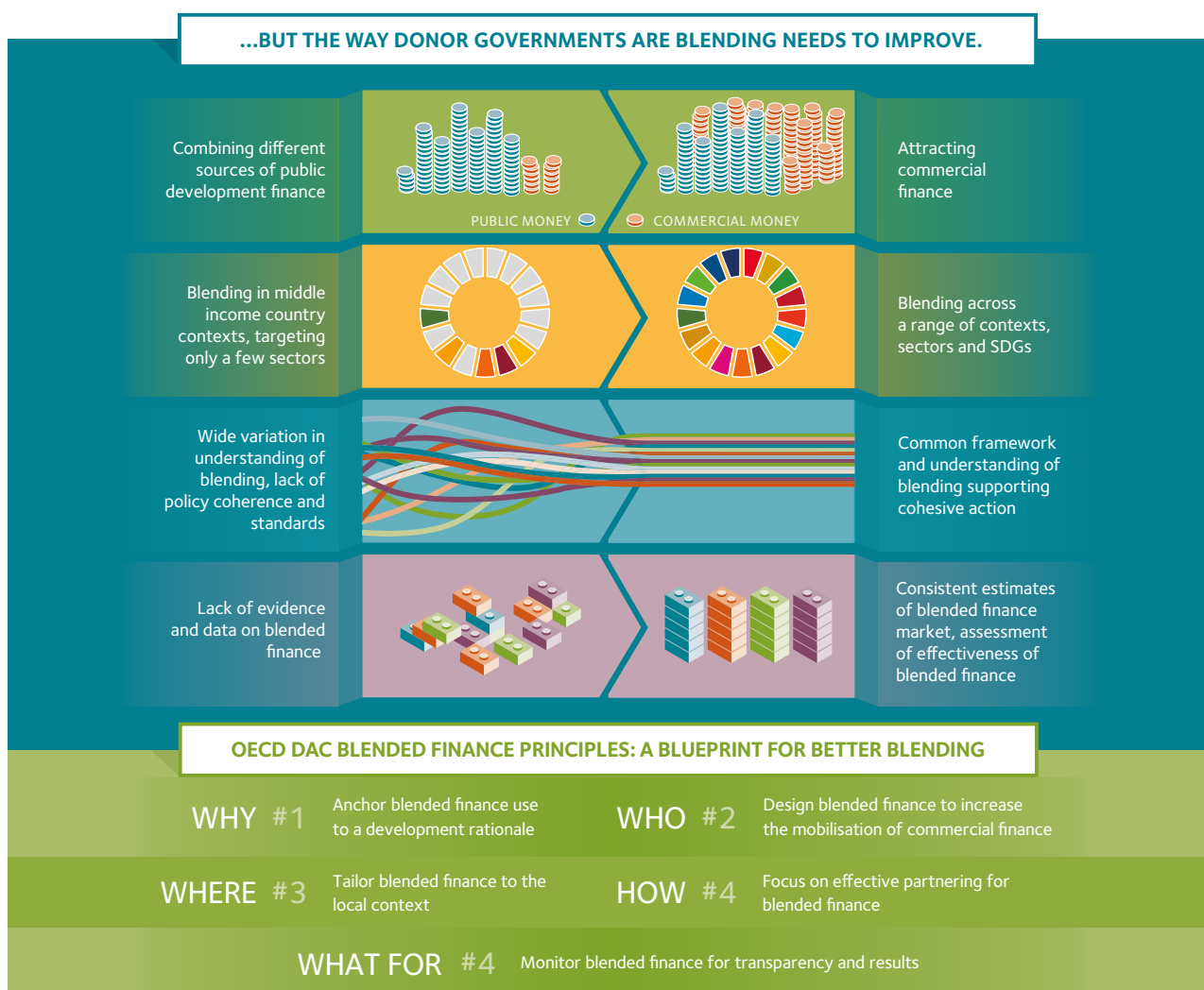
*Blended finance may not be the right tool to apply in all contexts, but it would be helpful to understand if there are opportunities to use blending to mobilise private finance towards different goals [...] and while blended finance may not be applicable to all sectors at a given point in time, it will*

*be important not to limit the outlook and focus on particular sectors but rather to continue targeting new solutions and public-private approaches as they emerge.<sup>41</sup>*

The OECD's ambition to promote blending in most contexts is reflected in the visualisation of future blending, where it is envisioned that blending will in the future contribute to all SDGs (see picture 5):

Alternatively, we could conclude that it is not only *difficult* to strike blended finance deals in social sectors that have traditionally been publicly financed. It may simply not be *appropriate* – and therefore, efforts should be made to mobilise more public finance to these sectors, domestic as well as international (ODA). The fact that privatisation in social sectors tend to provoke popular resistance and protests of course adds weight to this argument.

PICTURE 5. OECD'S PERSPECTIVE ON THE ROLE OF BLENDED FINANCE



OECD argues that blending should be spread to more sectors, SDGs and contexts.

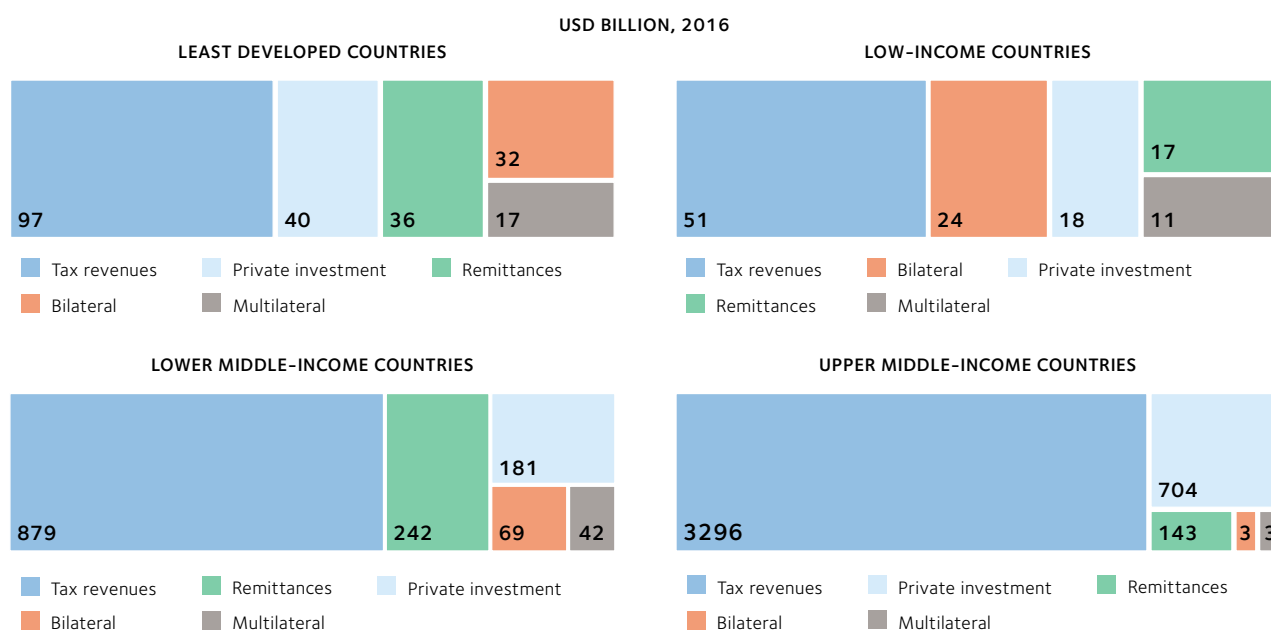
Source: OECD 2018, *Making Blended Finance Work for the Sustainable Development Goals*, revised version.

# THE ENDURING NECESSITY OF PUBLIC FINANCE

The comparison between ODA levels and the SDG funding gap that is sometimes highlighted as an argument for the necessity of increased private investment through blended finance is not relevant. Instead, the SDG funding gap should be related to all forms of finance for development.<sup>42</sup> In particular, more attention

should be given to the need and potential to increase *public finance* – whether nationally mobilised or ODA. Domestic public resources is and remains the backbone of development finance, even in LDCs. This point is clearly illustrated by OECD in the recent Global Outlook on Finance for sustainable development (See picture 6).<sup>43</sup>

FIGURE 6. RELATIVE IMPORTANCE OF DIFFERENT FORMS OF DEVELOP FINANCE



On average, tax revenues is the largest financial resource for all developing countries regardless of income category.

Source: OECD.

According to the OECD, tax revenues in developing countries amounted to USD 4.3 trillion in 2016 and revenues from fair taxation need to increase: “The tax revenue-to-GDP ratios in low-income countries (LICs) and least developed countries (LDCs) average 14% and remain below the 15% threshold that is increasingly recommended as a minimum benchmark for effective state functioning.”<sup>44</sup> In contrast, tax ratios in HICs vary between 30 and 50+, the highest ratios tend to be found in countries with very high HDI.<sup>45</sup> It should be added that in order to have a positive development impact, the tax system must be fair and progressive.<sup>46</sup>

It is not possible nor desirable to determine the balance between public and private finance in a general way, given the political nature of the choice. However, based on assessments of the total financing needs in different sectors in a specific country, and consideration of whether blended finance is appropriate or not in these sectors, a very rough estimate of the proportion of public and private finance could be estimated. According to an analysis conducted by the Sustainable Development Solutions Network (SDSN), approximately half the funding required to achieve the SDGs in developing countries can be in the form of private investment.<sup>47</sup>

Let’s assume that this estimation is fairly good, that half of the financing gap must be filled by public money – most of it domestically mobilised. That means that ODA can and must be catalytic not only in relation to the private sector, but also in relation to public institutions. More ODA should be dedicated to building progressive tax systems and rule of law, be it through institutional capacity building, support to the development of national development institutions, international tax cooperation to stop tax dodging, provision of Tax inspectors without borders<sup>48</sup>, or support to CSOs who hold their governments accountable.

To insist that we should put more focus on public finance is to swim against the tide. Over the past decades, countries have become richer but governments have become poor – the rise of private capital and fall of public capital is a global trend.<sup>49</sup> On the other hand, it is increasingly recognised that growing inequality is a serious threat to our societies in many ways, and that the great challenges of today must be met through common efforts.

# CONCLUSIONS

At present, neither private nor public finance delivers on the scale necessary to meet the SDGs. Efforts need to be stepped up on both fronts, including delivery on the commitment to increase ODA to 0.7 per cent of BNI. Whether supported through blending or not, businesses need to develop socially focused business models that contribute to the implementation of the SDGs.<sup>50</sup>

Blended concessional finance can play a significant role in helping to pioneer and create new markets, foster innovation and invest at the earliest stages of projects, when risk levels are at their highest and when private investors need a greater risk mitigation. However, if blended finance is to be scaled up in the sectors and contexts where positive impact on SDGs are most significant, MDBs and DFIs will need to make fundamental changes to their business models and take on riskier projects.<sup>51</sup>

In order for the positive development impact to materialise, a number of important “how-issues” have to be carefully identified, considered, managed and monitored. Further efforts should be made to develop modalities and guidelines in support of this.

In the development of policies and guidelines for blended finance, it is important to secure that blended finance does not replace grant-based aid and humanitarian relief in contexts where this kind of finance is needed, but relieve public resources to be concentrated on interventions that address the poorest and most vulnerable.<sup>52</sup> Otherwise, ODA risk leaving many sectors, countries and people without

any development finance, when in fact there is an urgent need for much more of it in these contexts.

The original version of picture 5 above illustrates the risk that many NGOs warn against in relation to blended finance: that it will crowd out ODA rather than crowd in private finance. In its original version, the pile of blue (public) coins was considerably smaller in the improved version of blending (second column).<sup>53</sup> The lack of data on how much ODA is actually used for blending makes this discussion difficult.<sup>54</sup> However, as noted in a recent working paper from OECD, the risk that ODA for blending is crowding out ODA for other purposes may not be theoretical:

*Development finance providers must ensure that allocating scarce concessional resources for blending does not draw them away from other types of intervention that may be more effective in a given circumstance. (...) Hence, blended finance might require large amounts of concessional funding in [fragile] contexts, which increases the likelihood of drawing funds away from other types of intervention.*<sup>55</sup>

Also, in a recent paper an effort has been made to quantify the opportunity cost of blended finance, in terms of reduced allocation of ODA to social and humanitarian sectors.<sup>56</sup>

It should be noted that guarantees offered by the Swedish development agency Sida do not run the risk of crowding out grant aid, since they are backed by the Swedish government (National Debt Office) rather than by a guarantee fund based on ODA. Other donors should be encouraged to use a similar model.<sup>57</sup>



As a general remark, it could be added that a too strong focus on blended finance among donors may create an incentive to use blending for projects where in fact other tools are more appropriate.

Ultimately, the fundamental choice for policy makers between private, public and blending is not a “development” issue relating to “development finance”. The ultimate question, North and South, is: When are public subsidies or guarantees to private companies justifiable and needed to promote private investments that are considered necessary to obtain overarching national objectives?

## RECOMMENDATIONS TO POLICY MAKERS

- Recognise that blended finance is neither possible nor appropriate in all sectors and contexts. The choice between private and public finance, or a combination of the two, is a political one that has to be made at national level. It will vary between countries and over time. In general, however, the risk that financing basic social services through blended finance may undermine human rights and the commitment to leave no one behind (LNOB) need to be considered.
- Refrain from setting mobilisation targets, since these may distort incentives for ensuring financial additionality, priority for LIC and development impact.
- State clearly that blended finance will not replace or lead to reduced ODA grants or divert ODA currently going to the public sector. There should be a limit on maximum proportion of ODA that may go to blended finance, to minimise opportunity costs and send a clear signal about the level of ambition in using blending. Back guarantees with other resources than ODA funds.
- Include explicit considerations of whether blended finance is an *appropriate* finance mechanism in operational guidelines of financing institutions as well as in international norms and guidelines on blended finance. Focus efforts to scale up blended finance in sectors where there is greatest potential and least risks that the private investment may undermine LNOB and human rights.
- In LDC, where blending may not be enough to tip the balance for investments, grant ODA to strengthen the local investment environment should be considered as a first choice.<sup>58</sup>
- Give as much attention to the need to increase domestic public resources and improve public finance as on the need to scale up private finance. Scale up catalytic ODA to support national mobilisation of development finance.
- If the purpose is to make an investment sustainable, rather than make it happen, the alternative possibility to implement legal or other policy instruments should be considered (“shifting the trillions”).
- Reconsider business models of providers of development finance. Higher risks appetite (or lower rates of returns requirements) may be necessary in order to scale up blended finance in prioritised sectors.
- Develop good practices of blended finance, especially those involving small and medium enterprises (SMEs) and severely underfunded sectors such as agriculture.<sup>59</sup>



## EXAMPLES OF “HOW ISSUES”

The issues are presented in relation to the development effectiveness principles:

### 1. OWNERSHIP OF DEVELOPMENT PRIORITIES BY DEVELOPING COUNTRIES

- Alignment with national development priorities.
- Working through national development banks and in local currencies.
- Balance between support to developing market institutions and support to individual investments.
- No distortion of the market through over subsidisation – avoid crowding out local businesses.
- No increase in tying of aid.

### 2. TRANSPARENCY AND ACCOUNTABILITY FOR DEVELOPMENT RESULTS

It is a challenge to hold stakeholders accountable in projects financed through blending. Many different stakeholders are involved in complex financing structures, and private actors do not disclose all relevant information on grounds of business confidentiality. In a OECD document it is noted:

*Financial information on blended operations is not systematically disclosed, on grounds of confidentiality. The use of concessionality represents commercially sensitive information. Some believe that donors should invalidate this reasoning, since real trade secrets are not written in contractual agreements. In addition, donors manifest their difficulty in tracking financial contributions to collective investment vehicles (CIVs) and matching them with the reported outflows. Transparency on the use of public subsidies is highly demanded in order to avoid the risk of commercial capture, but the influence donors might exert in blended finance decreases along the delivery chain.\**

### 3. A FOCUS ON RESULTS

- Who will benefit from the investment? How will they benefit, and when?
- Human Rights Due Diligence, and strong legal and regulatory frameworks that protect human rights, labour rights, and the environment.
- Financial and developmental additionality.
- Impact on gender equality and the empowerment of women and girls, and on other marginalised groups (Leave No One Behind)
- Inclusive reviews of progress and results for mutual accountability, monitoring, evaluation.
- Ensuring that private actors supported through blending pay taxes.

### 4. INCLUSIVE PARTNERSHIPS

- Participation – consultations with local communities, implementing complaints mechanisms.
- Democratic space and enabling environment for civil society.

For a detailed discussion, see: Cordelia Lonsdale (2016), *Aligning blended finance with the Busan principles of development effectiveness*; and Development Initiatives (2019), *How blended finance reaches the poorest people: theory and practice*.

\* Winckler Andersen, O. et al. (2019), “Blended Finance Evaluation: Governance and Methodological Challenges”, *OECD Development Co-operation Working Papers*, No. 51, sid 11.  
<http://dx.doi.org/10.1787/4c1fc76e-en>

# ACRONYMS

AAAA	Addis Ababa Action Agenda on Financing for Development
BMZ	Federal Ministry for Economic Cooperation and Development (Germany)
BSDC	Business & Sustainable Development Commission
CSO	Civil society organisation
DFID	Department for International Development (UK)
DCED	Donor Committee for Enterprise Development
DFI	Development finance institution
EFSD	European Fund for Sustainable Development
FMO	The Dutch development bank
GNI	Gross National Income
IFC	International Finance Corporation
IMF	International Monetary Fund
HDI	Human development index
HIC	High-income country
LDC	Least developed country
LIC	Low-income country
LNOB	Leave no one behind
MDB	Multilateral development bank
MFD	Maximise finance for development
MIC	Middle-income country
NGO	Non-governmental organisation
ODA	Official development assistance
ODI	Overseas Development Institute
OECD DAC	Development Assistance Committee of the OECD
PPP	Public-private partnership
Sida	Swedish International Development Authority
SDG	Sustainable development goal
SME	Small and medium enterprise
UNCDF	United Nations Capital Development Fund
USAID	United States Agency for International Development
WB	World Bank
WEF	World Economic Forum

# REFERENCES

<sup>1</sup> “Blending” is sometimes used to describe the combination of different sources of public development finance, but in this paper we use the OECD definition which distinguishes between “development” and “commercial” finance rather than “public” and “private”. In practice, “development finance” is mostly public but also includes philanthropic capital, and “commercial” is mostly but not always private. For a discussion on different definitions see for example Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI, and Melina Heinrich-Fernandes (2018), *Donor engagement in Innovative Finance: Opportunities and Obstacles*, DCED.

<sup>2</sup> OECD (2018), *Making Blended Finance Work for the Sustainable Development Goals*; Business & Sustainable Development Commission, BSDC; (2018), *Better Finance Better World: Consultation paper of the Blended Finance Task Force*; Convergence and BSDC (2017), *The State of Blended Finance*; WB and others, 2015. *From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development Finance*.

<sup>3</sup> Eurodad (2013), *A dangerous blend? The EU’s agenda to ‘blend’ public development finance with private finance*; CSO Partnership for Development Effectiveness, CPDE, (2019) “Civil Society Manifesto for Effective Development Cooperation”. [https://docs.wixstatic.com/ugd/9f29ee\\_c6e-57e2feb4a49428bc8ea2b2cc8fe64.pdf](https://docs.wixstatic.com/ugd/9f29ee_c6e-57e2feb4a49428bc8ea2b2cc8fe64.pdf)

<sup>4</sup> For example: How can the risk of over-subsidisation and markets distortions be minimized? How can transparency be improved in a business context where confidentiality is the norm? How can the number of bankable projects be increased? How can investments be tailored to local contexts? How can we make sure that investments mobilised through blended finance follow the principles of development effectiveness?

<sup>5</sup> OECD (2019), “Report from Private Finance for Sustainable Development Week 15-18 January”.

<sup>6</sup> Five common impact indicators: 1) jobs created, 2) number of people with new or improved access to services, 3) government revenue generated, 4) electricity generated from renewable sources, and 5) CO2 emissions reduced or avoided. For a thorough discussion on impact, see Development Initiatives (2019), *How blended finance reaches the poorest people: theory and practice*.

<sup>7</sup> OECD (2018), *Global Outlook on Financing for Sustainable Development 2019: Time to Face the Challenge*.

<sup>8</sup> From the foreword of OECD DAC Blended Finance Principles (2018): “All relevant, higher level, commitments made by DAC Members in relation to development co-operation apply to blended finance in the same way as to other financing approaches. These include, amongst others, commitments on official development assistance (ODA) financing targets, the commitment on leaving no one behind, commitments related to development effectiveness, as well as those related to untying aid.”

<sup>9</sup> Of course, dealing with the “how”-questions in a particular context may lead to a reconsideration of a first conclusion that a specific blended finance investment is appropriate. If there is not a broad country ownership, for example, blended finance may not be appropriate.

<sup>10</sup> <http://www.oecd.org/development/financing-sustainable-development/blended-finance-principles/>

<sup>11</sup> DFI Working Group on Blended Concessional Finance for Private Sector Projects Joint Report, October 2018 Update.

<sup>12</sup> Convergence (2018), *The State of Blended Finance 2018*, p 33.

<sup>13</sup> Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI, p 55.

<sup>14</sup> It could be noted that one reviewer of this paper suggests that providers of blended finance are often more concerned with financial additionality and the risk of market distorting impacts while practitioners are more concerned with development additionality.

<sup>15</sup> Javier Pereira (2017), *Blended Finance: What it is, how it works and how it is used*. Research report, Oxfam and Eurodad. OECD uses a broader definition of development impact: “development results that could not have been achieved without the mobilisation of commercial capital” or simply “that the mobilised funds are used for sustainable development”. Winckler Andersen, O. et al. (2019), “Blended Finance Evaluation: Governance and Methodological Challenges”, *OECD Development Co-operation Working*

Papers, No. 51, p 15. OECD Publishing, Paris. <http://dx.doi.org/10.1787/4c1fc76e-en>

<sup>16</sup> Javier Pereira (2017), “Blended finance for development. Background paper prepared for the Intergovernmental Group of Experts on Financing for Development”, UNCTAD.

<sup>17</sup> Convergence (2018), *The State of Blended Finance* 2018, p 5.

<sup>18</sup> Leverage ratios are less than 0.37 in LIC, 1.06 in LMIC and 0.65 in UMICs. Samantha Attridge and Lars Engen, 2019. *Blended finance in the poorest countries: the need for a better approach*, ODI.

<sup>19</sup> See for example discussion at p 19 in Winckler Andersen, O. et al. (2019), “Blended Finance Evaluation: Governance and Methodological Challenges”, *OECD Development Co-operation Working Papers*, No. 51, OECD Publishing, Paris. <http://dx.doi.org/10.1787/4c1fc76e-en>

<sup>20</sup> Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI, p 26.

<sup>21</sup> “At the nexus of impact investing and blended finance, there may well be a trade-off between financial returns and impact. This seems to be especially the case for funds focusing on early-stage businesses and those making investments in high-risk sectors or regions.” Koenig and Jackson (2016), *Private Capital for Sustainable Development: Concepts, Issues and Options for Engagement in Impact Investing and Innovative Finance*, Evaluation Study 2016/2, Danida, p 45.

<sup>22</sup> OECD (2018), *Global Outlook on Finance for Sustainable Development 2019: Time to Face the Challenge*.

<sup>23</sup> See for example Kruskaia Sierra-Escalante et al. (2019), “Blended Concessional Financial: Governance Matters for Impact”, *IFC Emerging Markets Compass*, note 66.

<sup>24</sup> Sony Kapoor (2019), “Billions to Trillions – A Reality Check. Blending: Development Finance Institutions and Financing the Sustainable Development Goals”. *RE-DEFINE Policy Brief for Stamp Out Poverty*.

<sup>25</sup> Pers. Comm. San Bilal, European Centre for Development Policy Management (ECDPM), January 15 2019.

<sup>26</sup> Sony Kapoor (2019), “Billions to Trillions – A Reality Check. Blending: Development Finance Institutions and Financing

the Sustainable Development Goals”. *RE-DEFINE Policy Brief for Stamp Out Poverty*.

<sup>27</sup> Key norms are for example The European Consensus On Development, “Our World, Our Dignity, Our Future” (2017) and Agenda 2030, including e.g. the commitment to leave no one behind and SDG 10, Reduce inequality within and between countries.

<sup>28</sup> World Bank (2018), “*Maximizing Finance for Development (MFD)*”. <https://www.worldbank.org/en/about/partners/maximizing-finance-for-development>

<sup>29</sup> Sony Kapoor (2019), “Billions to Trillions – A Reality Check. Blending: Development Finance Institutions and Financing the Sustainable Development Goals”. *RE-DEFINE Policy Brief for Stamp Out Poverty*.

<sup>30</sup> Wemos (2019), Best public value for public money? The case of match-funded multi-hospital infrastructure development in Tanzania. Discussion paper.

<sup>31</sup> UNCDF (2018), *Blended Finance in the Least Developed Countries*, p 1 (summary): “...when it comes to providing many public services, domestic public finance, supported by ODA as necessary, might be the best option”.

<sup>32</sup> Guido Schmidt-Traub and Jeffrey D. Sachs (2015), *Financing Sustainable Development: Implementing the SDGs through Effective Investment Strategies and Partnerships*. Sustainable Development Solutions Network (SDSN), p 31f.

<sup>33</sup> Business & Sustainable Development Commission, BSDC, (2018), *Better Finance Better World: Consultation paper of the Blended Finance Task Force*.

<sup>34</sup> María José Romero (2017), *De-risking or risk-shifting? The World Bank’s proposed strategy to bridge the ‘infrastructure gap’, Bretton Woods Project*. See also a balanced discussion in UN Inter-agency Task Force on Financing for Development, *Financing for Sustainable Development Report 2019*, p 61.

<sup>35</sup> Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI, p 56.

<sup>36</sup> Jesse Griffiths and María José Romero (2018), “Three compelling reasons why the G20’s plan for an infrastructure asset class is fundamentally flawed”, Eurodad.

<sup>37</sup> Swedish National Audit Office (2016), *Summary: Experiences of the PPP solution for the Arlanda rail link*. Report number RIR 2016:3.

<sup>38</sup> Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI.

<sup>39</sup> Convergence (2018), *The State of Blended Finance*; UNCDF (2018), *Blended Finance in the Least Developed Countries*; OECD (2018), *Making Blended Finance Work for the Sustainable Development Goals*, P27: "The SDGs most targeted by funds and facilities are those focusing on economic growth and jobs (SDG 8), infrastructure (SDG 6, SDG 7, SDG 9, SDG 11), climate change (SDG13), and goals that cut across most others (SDG 1, SDG 17). In contrast, the SDGs least targeted by funds and facilities were related to biodiversity and natural resources (SDG 14 and SDG 15). This pattern reflects the tendency for blended finance to go towards sectors for which the business case is clearer and the potential for commercial gains more apparent."

<sup>40</sup> Development *Initiatives* (2016), *Blended finance: Understanding its potential for Agenda 2030*, p 14.

<sup>41</sup> OECD (2018), *Making Blended Finance Work for the Sustainable Development Goals*, p 27.

<sup>42</sup> The Addis Ababa Action Agenda (AAAA) mentions the following main categories: A. Domestic public resources, B. Domestic and international private business and finance, C. International development cooperation, D. International trade as an engine for development, and E. Debt and debt sustainability.

<sup>43</sup> OECD (2018), *Global Outlook on Financing for Sustainable Development 2019: Time to Face the Challenge*. Overview document.

<sup>44</sup> OECD (2018), *Global Outlook on Financing for Sustainable Development 2019: Time to Face the Challenge*. Overview document, p 5.

<sup>45</sup> Government revenue data in most countries can be found here: <https://www5.wider.unu.edu/#/>

<sup>46</sup> The Addis Ababa Action Agenda para 22: "... We commit to enhancing revenue administration through modernized, progressive tax systems, improved tax policy and more efficient tax collection. We will work to improve the fairness,..."; SDG 10.4: "Adopt policies, especially fiscal, wage and social protection policies, and progressively achieve greater equality."

<sup>47</sup> An emphasis on public investments is suggested for SDG 3, 4 and 16. Emphasis on private investments is suggested for SDG 7, 9 and 13. Guido Schmidt-Traub and Jeffrey D. Sachs (2015), *Financing Sustainable Development: Implementing the SDGs through Effective Investment Strategies and Partnerships*. Sustainable Development Solutions Network (SDSN).

<sup>48</sup> <http://www.tiwb.org/>

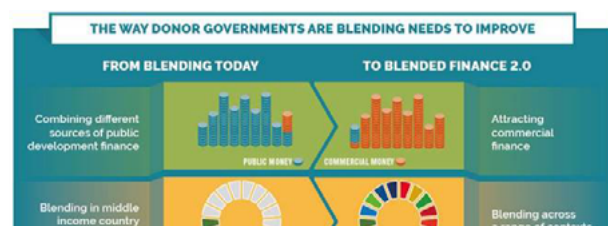
<sup>49</sup> Facundo Alvaredo *et. al.* (2018), *World Inequality Report 2018*, Harvard University Press.

<sup>50</sup> The Business & Sustainable Development Commission, BSDC, (2017), *Better Business Better World*.

<sup>51</sup> Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI.

<sup>52</sup> UNCDF (2018), *Blended Finance in the Least Developed Countries*, p 1 (summary): "While blended approaches seek to increase overall financing for the SDGs, absent an increase in the overall level of aid, using more ODA for blending may result in a decrease in its use for such purposes as helping to fund basic infrastructure or social services in LDCs—sectors not usually suitable for blending."

<sup>53</sup> The original version of the picture, "Blended Finance 2.0", is still included in the report and overview that could be downloaded on November 7, 2019 at <http://www.oecd.org/publications/making-blended-finance-work-for-the-sustainable-development-goals-9789264288768-en.htm>



Most probably, the intention was that the picture should be interpreted in a relative way – the proportion rather than the amount of public money will decrease.

<sup>54</sup> Oxfam (2017), *Private-Finance Blending for Development: Risks and Opportunities*; Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI.

<sup>55</sup> Winckler Andersen, O. *et al.* (2019), "Blended Finance Evaluation: Governance and Methodological Challenges", *OECD*

*Development Co-operation Working Papers*, No. 51, OECD Publishing, Paris. <http://dx.doi.org/10.1787/4c1fc76e-en>

<sup>56</sup> Polly Meeks et. al. (2020), *Mobilising Private Development Finance: Implications for Overall Aid Allocations*, EBA 01 2020.

<sup>57</sup> Sida's guarantee Portfolio 2017. Fact sheet 2017-12-30; UNCDF (2018), *Blended Finance in the Least Developed Countries*, Box 17: "What is a Sida guarantee, and how does it work?"

<sup>58</sup> Sony Kapoor (2019), "Billions to Trillions – A Reality Check. Blending: Development Finance Institutions and Financing the Sustainable Development Goals". *RE-DEFINE Policy Brief for Stamp Out Poverty*; Samantha Attridge and Lars Engen (2019), *Blended finance in the poorest countries: the need for a better approach*, ODI.

<sup>59</sup> In 2018 Act Church of Sweden and We Effect submitted the proposal "Innovative finance for improved livelihood in Kenya and Uganda", a pilot project that combines a Loan Guarantee Facility with (grant) Capacity Building Initiatives to Sida; Bert van Manen et. al. (2018), *Critical Capital for African Agri-Food SMEs. A review or demand for and supply of risk capital for agri-food SMEs in Sub-Saharan Africa. Based on field studies in Kenya, Tanzania, Zambia and Mali*. AgriProFocus, Rabobank Foundation and ICCO Cooperation.

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