

EXECUTIVE SUMMARY

Delivering the Sustainable Development Goals (SDGs) and the Paris Agreement will require more resources than are currently being spent on development outcomes, not least in developing countries. Blended finance, an approach that mixes different forms of capital to support development, is emerging as a solution to help achieve the “billions to trillions” agenda. Scaling up blended finance without a sound understanding of its potential and its risks, however, may have unintended consequences for development co-operation providers. This report presents a comprehensive assessment of the state of blended finance and priorities for action to

improve its implementation, drawing on surveys, case studies, interviews and desk research. It argues that while blending has potential to scale up commercial finance for the Sustainable Development Goals, its deployment by the development finance community needs to be based on a common framing and principles, as well as additional evidence and analysis. While this report is meant primarily for a development co-operation and finance audience, its findings and recommendations are useful for a broader range of policy makers and practitioners pursuing sustainable development in developing countries.

Key findings

Blended finance has potential to help bridge the estimated USD 2.5 trillion per year investment gap for delivering the SDGs in developing countries.

Taking stock of financing for the SDGs two years into the Addis Ababa Action Agenda, the Inter-Agency Task Force on Financing for Development (2017) reports that growth in capital for these investments largely has not materialised. Public development finance alone, from governments and donors, will not be sufficient to achieve the sustainable development agenda; it needs to catalyse and mobilise other sources of financing for development. While there is no shortage of capital worldwide, a lack of risk-adjusted returns constrains commercial investors from investing in projects in developing countries. This is where blended finance could make a difference. By deploying development resources to improve the risk-return profile of individual investments in developing countries, blended finance can attract commercial, private financing, help to demonstrate project viability and build markets that ultimately are able to attract further commercial capital for development.

A critical first step to effective blended finance is a common definition. There is much ambiguity and variety in the ways blended finance is defined, even among members of the OECD Development Assistance Committee (DAC). This report and the OECD DAC Blended Finance Principles, which were endorsed by the DAC High Level Meeting in 2017, present a definition and framework to support donor governments in designing approaches that mobilise and better target commercial capital towards the SDGs.

Blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries.

Additional finance is commercial finance that does not have an explicit development purpose and that has not primarily targeted development outcomes in developing countries, and development finance is public and private finance that is being deployed with a development mandate. This framing of blended finance distinguishes finance by purpose rather than by source, moving away from the emphasis on public/private actors to highlight development/commercial finance flows. It is broader than those used by multilateral development banks (MDBs) and development finance institutions (DFIs) in that it does not depend on concessionality as a pre-requisite for blending and considers blending in the context of both public and private investments. Blended finance occurs within the context of a specific transaction, and differs from public support for policy and regulatory reform which also has a role in unlocking commercial capital in developing countries.

Donor governments and other development finance providers increasingly use blended finance.

At least 17 members of the OECD DAC now engage in blended finance, although they are at very different stages in terms of the range of instruments used and how blending is carried out. MDBs and bilateral DFIs also engage in blending, both as facilitators of blended transactions and using their own finance. Between 2000 and 2016, donor governments set up 167 dedicated

facilities that pool public financing for blending and the number of new facilities grew every year, according to surveys by the OECD in 2017 and the Association of European Development Finance Institutions (EDFI). This growth is a sign of increasing donor interest but it also demonstrates increasing fragmentation in approaches and vehicles used. Attracting commercial capital at scale will require some degree of standardisation in terms of both access to development finance and instruments used.

Development actors are using blended finance as an innovative way to mobilise capital. The instruments used extend beyond the more traditional loans and grants to include the use of guarantees, securitisation, currency hedging and political risk insurance. Structured blended finance funds are one example where donor governments use concessional finance in a first loss position and provide a risk cushion which help to attract commercial investors. Another blending model garnering interest is impact funds, in which development finance providers and private actors invest with the aim of generating financial returns and measurable development impact. Across the different

models, engagement with local public and private actors, and efforts to build local financial markets, can support the long-term sustainability of the project.

While interest in blending is increasing, the evidence base on blended finance is still quite limited. Different efforts have aimed to map the blending landscape but have not produced a single, consistent and comparable estimate of the blended finance market that covers the entirety of flows. The OECD is engaged in work on tracking the volume of private finance mobilised by official development finance interventions that will be institutionalised in the reporting system for OECD DAC members, representing a useful advance in this regard. Significant shortcomings in existing monitoring and evaluation systems also contribute to gaps in the evidence base that have implications for blended finance. Developing these systems for blended finance is particularly challenging because they must satisfy the needs of quite distinct and diverse stakeholders. Initial evidence shows that monitoring and evaluation of blended finance funds and facilities are less developed than for other development co-operation activities.

Policy recommendations

Development finance providers need to move towards blended finance 2.0. This report finds that while blended finance has potential to support financing for development, donor governments need to guide its deployment to ensure it meets the needs of the SDGs. Blended finance is not a silver bullet that will solve the myriad challenges associated with mobilising investment for the SDGs. It is one pillar in an array of development finance approaches that will have to complement each other in order to deliver the resources needed. The report recommends that donor governments need to move towards 'blended finance 2.0' i.e. to ensure that blended finance mobilises commercial resources that are not currently supporting development and better target blended finance to a broader range of development issues (i.e. SDGs) and contexts. In this regard, the OECD DAC Blended Finance Principles, developed concurrently with this report, identifies five areas for action:

- Anchor blended finance use to a development rationale (Principle 1)
- Design blended finance to increase the mobilisation

of commercial finance (Principle 2)

- Tailor blended finance to local context (Principle 3)
- Focus on effective partnering for blended finance (Principle 4)
- Monitor blended finance for transparency and results (Principle 5)

The proof of blended finance for the SDGs ultimately will ultimately depend on how it is deployed. As an approach to mobilise investment, and to bring development and commercial actors together, blended finance has potential if the development community acts together to ensure its application is based on mutually agreed standards and guidelines. This report and the OECD DAC Blended Finance Principles are a significant contribution to on-going joint efforts to establishing a common framework for blended finance by key stakeholders. The SDGs call for concerted action, bringing together all actors, to drive forward progress in developing countries. Ultimately, how well blended is deployed will determine how far it goes in supporting this global agenda.