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Research Report

Blended finance in the poorest countries: The need for a better approach

ODI Report

Provided in Cooperation with:

Overseas Development Institute (ODI), London

Suggested Citation: Attridge, Samantha; Engen, Lars (2019) : Blended finance in the poorest countries: The need for a better approach, ODI Report, Overseas Development Institute (ODI), London

This Version is available at:

<https://hdl.handle.net/10419/206745>

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Report

Blended finance in the poorest countries

The need for a better approach

Samantha Attridge and Lars Engen

April 2019

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Acknowledgements

The authors would like to thank the peer reviewers who kindly gave their time to provide very helpful critique and comments: Paddy Carter (CDC Group), Charles Kenny (Centre for Global Development), Paul Horrocks (Organisation for Economic Co-operation and Development, OECD), Cécile Sangare (OECD), Tomas Hos (OECD), Soren Andreasen (Association of European Development Finance Institutions, EDFI), Morten Lykke Lauridsen (International Finance Corporation, IFC), Artur Karlin (International Finance Corporation, IFC), Neil Gregory (IFC), Joan Larrea (Convergence), Marcus Manuel (Overseas Development Institute, ODI), Jesse Griffiths (ODI), David Watson (ODI) and Hannah Caddick (ODI).

The authors would also like to thank colleagues from the following institutions for engaging in the research, providing comment and information: the Asian Development Bank (ADB), Agence Française de Développement (AFD), African Development Bank (AfDB), CDC Group, the United Kingdom Department for International Development (DFID), European Investment Bank (EIB), EDFI, International Development Association (IDA), IFC, Multilateral Investment Guarantee Agency (MIGA), OECD, Overseas Private Investment Corporation (OPIC), Proparco and Norfund.

The authors gratefully acknowledge the generous financial support from the Bill & Melinda Gates Foundation, AFD and Australia's Department of Foreign Affairs and Trade, which made this research possible.

All views expressed are those of the authors' alone and do not reflect those of the funder, ODI or the institutions reviewed in this report.

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Acronyms and abbreviations

ADB	Asian Development Bank
AFD	Agence Française de Développement (French Development Agency)
AfDB	African Development Bank
AIIB	Asian Infrastructure Investment Bank
CAF	Development Bank of Latin America
CGIF	Credit Guarantee and Investment Facility
CIF	Climate Investment Funds
CIV	collective investment vehicle
CPA	country programmable aid
CRS	creditor reporting system
DAC	Development Assistance Committee
DEG	Deutsche Investitions - und Entwicklungsgesellschaft mbH
DFI	development finance institution
DFID	Department for International Development (UK)
EBRD	European Bank for Reconstruction and Development
EDFI	Association of European Development Finance Institutions
EFSD	European Fund for Sustainable Development
EIB	European Investment Bank
EU	European Union
FY	financial year
GDP	gross domestic product
GEEREF	Global Energy Efficiency and Renewable Energy Fund
GNI	gross national income
HIC	high-income country
IADB	Inter-American Development Bank
ICD	Islamic Corporation for the Development of the Private Sector
ICT	information communications technology
IDA	International Development Association
IDFC	International Development Finance Club
IFC	International Finance Corporation
IsDB	Islamic Development Bank
LIC	low-income country
LMIC	lower-middle-income country
MDB	multilateral development bank

MIC	middle-income country
MIGA	Multilateral Investment Guarantee Agency
NDB	national development bank
ODA	official development assistance
ODF	official development finance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OOF	other official flow
OPIC	Overseas Private Investment Corporation
PIDG	Private Infrastructure Development Group
PSI	private-sector instrument
PSW	private-sector window
RDB	regional development bank
S&P	Standard and Poor's
SDG	Sustainable Development Goal
SME	small and medium enterprise
TOSSD	Total Official Support for Sustainable Development
UK	United Kingdom
UMIC	upper-middle-income country
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States (of America)
USAID	United States Agency for International Development
US IDFC	United States International Development Finance Corporation

Executive summary

The need to mobilise private finance is at the heart of international discussions on how to finance the Sustainable Development Goals (SDGs) and move the needle from ‘billions’ of dollars in development aid to ‘trillions’ of dollars in investment (World Bank, 2015). With an estimated SDG financing gap of \$2.5 trillion a year in developing countries alone (UNCTAD, 2014), the international development community is placing an increasing emphasis on blended finance.¹

Blended finance uses public-sector development finance to spur additional private investment in a bid to generate economic growth and create jobs, thus lifting people out of poverty. The notion of ‘billions to trillions’ (World Bank, 2015), though originally broader in meaning, has become synonymous with the mobilisation of private finance for development. However, policy-makers often have lofty aspirations, with limited appreciation of its potential and limitations. The more official development assistance (ODA) is channelled to blended finance, and the more blended finance is scaled up, the more pressing the need for better understanding of its potential to bridge the SDG financing gap.

This report aims to provide hard evidence to inform the discussion on the role of blended

finance in plugging the SDG financing gap in developing countries by:

- reviewing the amounts of private finance mobilised and estimating leverage ratios to assess the scale and potential of blended finance
- analysing the blended-finance landscape of country groups and economic sectors
- focusing on low-income countries (LICs), where the need for additional finance is greatest, and identifying factors likely to constrain blended finance’s potential there.

The report examines in detail the investment portfolios of the largest and most important blended-finance actors, which account for more than three quarters of the total private finance mobilised in LICs, according to the OECD.² It analyses the most recent four-year period for which comprehensive mobilisation data are available.³ The institutions included are:

- MDBs: IDA, IFC and MIGA
- regional development banks (RDBs): ADB, AfDB and EIB
- bilateral DFIs of developed countries: AFD (France), CDC Group (UK) and OPIC (United States) and its private-sector financing arm – Proparco – and Norfund (Norway).⁴

1 There is no common official definition of blended finance. For the purposes of this report, we define it as ‘the strategic use of official development finance (ODF) to mobilise additional private capital flows to developing countries to achieve the SDGs’. We discuss definitions and why we chose this focus in section 3.

2 Our selected multilateral development banks (MDBs) and development finance institutions (DFIs) mobilised 77% of total private finance mobilised overall and 85% of total private finance mobilised in LICs, as reported in the OECD 2016 mobilisation survey for 2012–2015 (which excludes China) (Benn et al., 2017).

3 We use the 2016 OECD mobilisation survey for the 2012–2015 period, as it contains the most comprehensive semi-disaggregated data available.

4 Annex 1 outlines our institutional selection process.

Key findings

Finding 1

Each \$1 of MDB and DFI invested mobilises on average \$0.75 of private finance for developing countries, but this falls to \$0.37 for LICs. Expectations that blended finance can bridge the SDG financing gap are unrealistic: ‘billions to billions’ is more plausible than ‘billions to trillions’. There is much talk by policy-makers of the potential of blended finance to mobilise significant sums of private finance. High financial leverage ratios are at the core of their arguments for investing ODA in blended finance, but our research shows that real leverage ratios are actually very low. Our database shows that, on average, for every \$1 of MDB and DFI resources invested, private finance mobilised amounts to just \$0.37 in LICs, \$1.06 in lower-middle-income countries (LMICs) and \$0.65 in upper-middle-income countries (UMICs). Leverage ratios are generally low across sectors, with a slightly higher ratio in the social sectors and the lowest ratios in LIC and middle-income country (MIC) infrastructure.

Finding 2

We need to better understand the poverty and development impact of blended finance, as well as its true costs, to ensure value for money and effective policy-making and allocation of ODA. We need to better understand the development impact of blended-finance investment and the value for money of official ‘subsidies’ if we are to understand their comparative value over other forms of development financing. Low leverage ratios suggest ODF will have to play a major role in blended-finance investment. Our estimates suggest that the public sector (the MDBs and DFIs) has on average picked up 57% of the cost of blended-finance investments to date and as much as 73% of the cost in LICs. Given that the public sector picks up much of the cost, and that often blended finance does not mitigate risk but merely transfers it from the private to the public sector, we need to understand better the development impact and value for money of investing ODA in blended finance.

As policy-makers task MDBs and DFIs with mobilising ever more private finance for LICs, they should be aware that leverage ratios may fall even further, requiring even bigger public subsidies to incentivise private investment in more marginal investment opportunities.

Finding 3

The potential of blended finance in LICs is hindered by factors such as poor investment climate, lack of investable opportunities, lack of tailored approach and low risk appetites of MDBs and DFIs.

Private commercial finance will not flow freely to countries where the investment climate is challenging, markets are not functioning and the risk-adjusted rate of return is uncompetitive. In fact, we estimate that 96.3% of private finance mobilised through blended finance flows to countries with a credit rating, which most LICs do not have. Blended finance may tip the balance, but it will not work if the economic fundamentals are not in place. So, the push for blended finance should not eclipse the need for grants to boost local investment environments.

Using concessional finance to blend can help 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 degree of risk mitigation. The data suggest, however, that MDBs and DFIs are primarily using less risky senior debt rather than instruments that are more risk appreciative to take on early-stage or ‘pioneer’ risk, such as subordinated debt, equity, risk-sharing facilities, guarantees or grants. The data also show very little variation in the instruments used in different country income groups. This suggests that the current blended-finance approach in LICs is not tailored to the risk requirements of private investors, which may limit the potential of blended finance to mobilise private finance in LICs.

Conservative MDB and DFI financing models and the returns required on blended concessional finance are dampening risk appetite and the ability to engage in LICs. MDBs’ willingness to assume risk is hindered by their need to maintain a AAA credit rating, while DFIs need to remain

profitable and financially sustainable. Both must take on greater risk if they are to mobilise more private finance for LICs. The answer to date has been for donors to provide more concessional finance, which they blend with their own-account resources, but this has not spurred a material shift in the overall risk appetite in the MDB and DFI system. Interestingly, bilateral institutions appear to play a more significant role in mobilising private finance for LICs than MDBs and RDBs. The comparative advantages of various types of institution, their approaches and how they can best complement each other warrant further exploration.

Finding 4

The big push for blended finance risks skewing ODA away from its core agenda of helping eradicate poverty in the poorest countries. ODA per capita is higher in LICs than other countries, but the opposite is true for blended finance. Changing policy incentives at the bilateral and multilateral levels to encourage greater use of ODA to mobilise private finance means we will see increased investment of ODA in blended finance. But it is easier to mobilise private finance in MICs and in ‘hard’ economic sectors. So, it is not surprising that blended finance is heavily concentrated in MICs and flows predominantly to the ‘hard’ economic sectors (infrastructure, banking and financial services), with very little to social sectors (health, education, social protection). This underscores the risk that the big push for blended finance may deflect ODA from the crucial investment needed to eradicate poverty in LICs. MDBs and DFIs will need to adopt a more tailored approach to ensure that this will not divert ODA away from LICs.

Finding 5

Effective policy-making has been thwarted by the lack of a common official blended-finance framework and poor data availability, hindering transparency and accountability, and undermining public trust in this approach. A lack of transparency and accountability undermines official efforts to build the case for more investment of ODA in blended finance,

denting public trust. This is at odds with the blended-finance principles agreed by the international community (DFI Working Group, 2017; OECD, 2018b). There is a clear disconnect between high-level political commitments to transparency and accountability and operational policies and rules.

Recommendations

Recommendation 1

If blended finance is to be scaled up, MDBs and DFIs will need to get better at using blending to mobilise private finance while managing the higher level of risk this implies.

If blended finance is to be scaled up, leverage ratios will need to increase significantly. MDBs and DFIs will need to make fundamental changes to their business models and take on riskier projects. Changes could include:

- making more use of concessional finance and subordinate instruments to meet the risk-mitigation needs of the private sector in LICs
- using more concessional finance to fund project preparation and early-stage project development, as well as to foster the use of more innovative risk-appreciative instruments
- revisiting the required rates of return on concessional resources used in blending and the ‘hurdle rates’ of bilateral DFIs: in other words, accepting higher levels of financial risk
- MDBs assessing capital adequacy in a more uniform way, allowing greater transparency of scope to take on risk and incorporate callable share capital into capital adequacy models.

Recommendation 2

Donors need to think carefully about the allocation of ODA and the risks and trade-offs of investing ODA in blended finance.

There may be other public policy interventions that are more transparent and effective in achieving development objectives than providing a direct subsidy to the private sector. For example, MDBs, DFIs and donors could make greater use of grant finance to strengthen the investment climates of LICs, focusing on

country-led programmes of policy reform, financial-sector development and capacity-building. Given that blended finance has not targeted well the poorest countries, and is not used equally in all sectors, donors need to manage the risk that increased investment of ODA in blended finance could further exacerbate the poor targeting of ODA, neglecting the countries and sectors that need it most.

Recommendation 3

There is an urgent need for better data and transparency.

Efforts should be made to align and harmonise the OECD and MDB blended-finance frameworks. All institutions should publish disaggregated project-level data. The OECD Development Assistance Committee (DAC) needs to resolve outstanding issues on the treatment of private-sector instruments in the modernisation of ODA and make efforts to publish the ‘grant equivalent’ of blended-finance transactions to the OECD Creditor Reporting System (CRS). This should be disclosed publicly at a semi-aggregated level to overcome the commercial confidentiality concerns of MDBs, DFIs and donors.

1 Introduction and overview

1.1 Introduction

The need to mobilise private finance is at the heart of international discussions on how to finance the SDGs. International and domestic public finance, alone, cannot plug the estimated \$2.5 trillion annual SDG financing gap in developing countries (UNCTAD, 2014), so private finance must play a crucial role. The international development community is placing growing emphasis on blended finance, which uses public development finance to mobilise additional commercial capital to bridge the financing gap and spur private investment for economic growth and job creation to lift people out of poverty. Aspirations are high, but there is limited political appreciation of the potential of blended finance in specific contexts. Policy-makers need to better understand when, where and how to use a blended-finance approach,⁵ and the circumstances in which it represents value for money.

Changing policy incentives at the bilateral and multilateral levels to encourage greater use of ODA to mobilise additional private finance means we will see increased investment of ODA in blended finance. However, three trends underscore the risk that this big push for blended finance may steer ODA away from LICs and

the investment in health, education and social protection needed to eradicate extreme poverty:⁶

- **First, while the volumes of private finance mobilised through blended finance are growing every year, the amounts are very limited compared with the estimated SDG financing gap.** The best estimates of private finance mobilised through blended finance by MDBs, DFIs and donors in LICs and MICs range from \$3.3 billion (DFI Working Group, 2018) to \$27 billion annually (Benn et al., 2017). This rises to \$59.4 billion if we use the latest data on total direct and indirect mobilisation (World Bank, 2018a).
- **Second, the private finance mobilised is heavily concentrated in MICs, with very little mobilised in LICs.** The best estimates of private finance mobilised by MDBs, DFIs and donors in LICs appear to be in the range of \$725 million (Benn et al., 2017) to \$1.6 billion annually (World Bank, 2018a). The upper end of the range rises to \$5.3 billion if we take the total direct and indirect mobilisation most recently reported by MDBs (ibid.).
- **Third, blended finance predominately mobilises private finance in ‘hard’ economic sectors, with very little going to the social sectors.**

5 It should be noted that the DFI community has developed broad ‘operational’ blended concessional finance principles (DFI Working Group, 2017) for DFIs to internalise in their operational procedures. The OECD DAC has also agreed ‘high-level’ policy principles (OECD, 2018b).

6 This risk is explored in section 4.2.

Blended finance is mobilising private finance in three sectors: infrastructure, banking and financial services,⁷ and the productive sectors.

This report aims to recalibrate the financing-for-development discourse by focusing on blended finance in LICs. It seeks to go further than the current literature by looking inside the investment portfolios of the largest official blended-finance actors overall and those mobilising private finance in LICs. It focuses on the top three actors in each of the following categories: (1) MDBs, (2) RDBs, and (3) bilateral DFIs. The institutions we focus on are IDA, IFC, MIGA, EIB, ADB, AfDB, OPIC, CDC, AFD, Proparco and Norfund.⁸ This disaggregated analysis is based on a unique new ODI database of the blended-finance commitments of these institutions. Our selected MDBs and DFIs mobilised 77% of total private finance mobilised overall and 85% of total private finance mobilised in LICs between 2012 and 2015, according to the (2016) OECD mobilisation survey (which excludes China) (Benn et al., 2017), so we have covered the main traditional international actors. Our analysis excludes national development banks (NDBs), which are important blended-finance actors in their countries. ODI is exploring the role of NDBs in blended finance and will publish its findings on the subject once its research is completed.

The goal of this report is to help calibrate the discussion on how and where ODA should be deployed and temper expectations as to the potential of blended finance in LICs. It does this in three ways:

First, we review the amounts of private finance mobilised and the financial leverage ratios in LICs, which suggest that the potential of blended finance in LICs is limited. At policy-making level, there is much talk of the potential of blended finance to mobilise significant sums of private finance. High leverage ratios are at the core of these arguments. While caution should be

exercised in their emphasis and interpretation, it is useful to look at leverage ratios, as they can help policy-makers gauge the potential of blended finance. To date, only highly aggregated leverage ratios are available (for the main MDBs, for example). We go further, estimating disaggregated leverage ratios (for instance, by income category and sector). We find that \$1 of public investment by MDBs and DFIs mobilises just \$0.37 of private finance in LICs, \$1.06 in LMICs and \$0.65 in UMICs. We also find that leverage ratios are low and fairly consistent across sectors.

Second, we present a disaggregated analysis of the blended-finance landscape, classified by country income. To date, there has been no analytical breakdown of the blended-finance landscape by national income and by institution. We observe that, in contrast to the overall trend, bilateral DFIs appear to play a more important role in LICs than MDBs and RDBs and that private finance mobilised in LICs is concentrated in relatively richer LICs. We find that infrastructure is the largest destination sector for blended investment and that very few MDBs and DFIs make any blended-finance commitments to LIC social sectors. We also find that loans are the most commonly used instrument for mobilising private finance in LICs and that the instruments used by MDBs and DFIs vary little across country income groupings. We also find that project size is significantly smaller in LICs.

Third, we identify factors that are probably constraining the potential of blended finance in LICs. We observe limited use of concessional finance to blend in LICs compared with UMICs and HICs and question whether more of it should be used in LICs. We argue that the potential of blended finance in LICs is constrained by several factors, most notably poor investment climates, a lack of investable opportunities, the limited use of subordinate instruments by MDBs and DFIs and the limited risk appetites of MDBs and DFIs.

7 Much of the investment categorised as being in the banking and finance sector is lent to local financial institutions, which lend on to local end-borrowers (mainly small and medium enterprises (SMEs) in a range of sectors, so we do not know the ultimate beneficiaries.

8 Annex 1 outlines our institutional selection process.

We make several recommendations to ease these constraints.

1.2 Overview

The first part of this report deals with the definitional and methodological issues that underpin our analysis (sections 2 and 3). The second part of the report is an analysis of the policy landscape and the blended-finance landscape in LICs (sections 4 to 7).

1.2.1 Part 1

The report discusses the various definitions of blended finance and the different methodologies used to measure the mobilisation of private finance, highlighting the implications of a lack of a common framework for data analysis, informed discussion and effective policy-making (section 2). The report then explores how we address these challenges, by outlining the scope and methodology underpinning our analysis. We summarise how we have defined blended finance for the purposes of this research and give an overview of our approach to data collection and data usage, including the creation of a new ODI blended-finance commitment database (section 3). A detailed description of the methodology used to build this unique database can be found in Annex 2.

1.2.2 Part 2

In section 4, we discuss the big push for blended finance, examining the rationale behind it and the changing incentives, which mean that we can expect to see a significant step up in investment of ODA in blended finance. This underscores the risk of ODA being diverted from LICs. In section 5, we discuss the potential of blended finance by comparing various official surveys and present an overview of global leverage ratios, including our own disaggregated leverage ratios, which are low overall and very low in LICs. We argue that the potential of blended finance to mobilise private finance in LICs is limited and that policy-makers need to temper their expectations accordingly.

Section 6 maps the landscape of blended finance in LICs. It focuses on the largest traditional MDBs and DFIs engaging in blended finance overall and in LICs and analyses their blended-finance portfolios in LICs. We focus our analysis on institutions for which data are available, based on our unique dataset of blended-finance commitments. In section 7, we identify several factors that are probably constraining the potential of blended finance in LICs, underlining the need for a more tailored approach. We summarise our conclusions in section 8.

2 Blended finance: no common conceptual framework

Key findings

- There is no common definition of blended finance at the official level. The lack of a common conceptual framework presents challenges in terms of data collection, analysis and comparability.
- Poor-quality data on the private finance mobilised and ODF invested, at both the aggregate and disaggregated project level, result in a lack of transparency that hinders informed analysis and understanding, informed discussion and, ultimately, effective policy-making.
- There is no consistent picture of the size and scope of blended finance or its development impact.
- A lack of transparency and accountability undermines official efforts to build the case for increased investment in blended finance and undermines public trust in this approach.

2.1 Numerous official definitions

There are myriad definitions of blended finance.⁹ This presents obvious challenges, as it means different things to different institutions and actors. At the official level, there is no common definition, so no common methodology for measuring blended finance on a consistent and comparable basis, with obvious adverse implications for transparency, accountability and effective policy-making.¹⁰

As the development finance landscape and thinking have evolved, so has the definition of blended finance. Where the discourse appears to have settled for now, we can see several common attributes that feature in the various definitions, namely:

- the use of concessional development finance
- the intent to mobilise additional finance, primarily private commercial finance¹¹
- some form of development impact associated with the investment.

9 See chapter 3 of OECD (2018b) and annex A of Development Initiatives (2016) for definitions and concepts.

10 There is an appreciation of these differences and nuances among practitioners at operational level, but far less understanding elsewhere.

11 For many years, blending public concessional resources with public non-concessional resources dominated the blended-finance approach. Much European Union (EU) blending was of this form, for example. EU grants were combined with other public (non-concessional) and, to a limited extent, private-sector resources to support public, private or mixed investment projects. The discourse has now shifted away from ‘public–public’ blending to ‘public–private’ blending; namely, the use of public resources to leverage private commercial finance.

Additionality is key. Two main forms of additionality are generally understood in the development finance context: (1) financial additionality, when public investment results in private investment that would not have materialised without it; and (2) development additionality,¹² whereby development impacts are secured in a commercial investment that would otherwise not have materialised. An assessment of additionality, especially financial additionality, is complex and challenging, not least because of the lack of counterfactual, and lies outside the scope of this research (Pereira, 2015; Carter et al., 2018). For the purposes of this research we adopt a conservative approach and assume that all the mobilised private finance reported is additional.

2.1.1 OECD DAC versus MDB, DFI and United Nations definitions

In essence, there are two main definitions that have gained traction in the development finance discourse. First, the OECD DAC definition,¹³ which is much broader in scope compared to the second, narrower definition adopted by the MDBs, DFIs and the United Nations (UN).

The OECD DAC defines blended finance broadly as:

the strategic use of development finance for the mobilisation of additional finance towards the SDGs in developing countries. (OECD, 2018a: 50)

Development finance, in the context of this definition not only includes ODF, both ODA and other official flows (OOF) (for example, MDB and DFI own-account resources),¹⁴ but also private finance governed by development mandates (such as philanthropic finance). Additional finance refers to public and private commercial finance with a non-developmental purpose.

MDBs and DFIs have adopted a narrower, more precise definition, which focuses on the use of concessional finance:

combining concessional finance from donors or third parties alongside DFIs' normal own-account finance and/or commercial finance from other investors, to develop private-sector markets, address the Sustainable Development Goals (SDGs), and mobilise private resources. (DFI Working Group, 2017: 3)

MDBs and DFIs distinguish between concessional finance provided by donors or third parties and their own-account non-concessional resources. Most MDB and DFI mobilisation of private-financing operations is funded solely from own-account resources and is not identified as blended finance by the institutions themselves. The operations are identified as blended finance by the OECD, however.

The MDB and DFI definition is broadly aligned with the definition adopted by the UN in the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, which focuses on the use of concessional finance and defines blended finance as financing that:

combines concessional public finance with non-concessional private finance and expertise from the public and private sector. (UNDESA, 2015: 24)

The three definitions essentially chime on the 'output' side of the equation (the mobilisation of commercial private finance), but differ on the 'input' side (what is invested to spur that mobilisation), as summarised in Table 1.

In a nutshell, what the OECD defines as 'blended finance', the MDBs and DFIs refer to as 'mobilisation' of private finance. MDBs and DFIs do not consider private-sector financing operations wholly funded by their own-account resources to be blended finance. MDBs and DFIs only consider own-account private-sector

12 Development additionality can also include other aspects of additionality, such as operational and institutional additionality.

13 The Business and Sustainable Development Commission concurs with and adopts the OECD DAC definition.

14 Own-account resources refer to the institutions' normal operational financing resources.

Table 1 Blended finance – definitional differences

'Input' classified as blended finance	OECD definition	MDB and DFI, UN definition
MDB and DFI own-account resources (invested on its own)	Yes	No
OOF (with a development mandate)	Yes	No
Concessional ODA (Donor or third-party concessional finance)	Yes	Yes
Philanthropic capital (with a development mandate)	Yes	No
Impact funds (Investment below market rate)	Yes	No

financing operations that are blended with third-party or donor concessional resources to be blended finance. This is a very small subset of their total private-financing operations and a very small subset of what the OECD would identify as blended finance.¹⁵

We thus find ourselves in an unsatisfactory situation in which the OECD DAC defines blended finance in a way that prevents thorough reporting¹⁶ and with which the MDBs and DFIs do not agree. Consequently, numerous MDBs and DFIs do not report in full to the OECD DAC and OECD CRS.

2.2 Understanding the 'output': mobilising private finance

Further confusing the issue is the fact that the OECD and MDBs have developed two different methodologies to measure the mobilisation of private finance (the 'output'), which yield vastly different results and are not comparable. As we

discuss the OECD and MDB surveys later in this report, here, we note the major methodological differences that affect their interpretation.

2.2.1 OECD DAC versus the MDB mobilisation measure

MDB methodology differentiates between 'direct' and 'indirect' mobilisation. MDBs define direct mobilisation as:

financing from a private entity on commercial terms due to the active and direct involvement of a MDB leading to commitment. Evidence of active and direct involvement include mandate letters, fees linked to financial commitment or other validated or auditable evidence of a MDB's active and direct role leading to commitment of other private financiers.
(World Bank, 2018a: 8)

15 Only a very small percentage of the total volume of MDB and DFI private finance operations every year would be classified as blended finance by MDBs and DFIs. This is calculated at approximately 5% during the period 2014 to 2016 (DFI Working Group, 2017) increasing to 8.8% in 2017 (DFI Working Group, 2018).

16 The rationale behind the adoption of such a broad definition is clear, however, as if it is defined it will be difficult for the OECD DAC to report on the definition in its entirety as there is no obligation for providers of development finance outside the DAC to report to the OECD (e.g. philanthropic actors).

They define indirect mobilisation as:

financing from private entities provided in connection with a specific activity for which an MDB is providing financing, where no MDB is playing an active or direct role that leads to the commitment of the private entity's finance. (ibid.)

There are differences between the MDB and OECD methodologies, meaning the respective survey results are not comparable. Essentially, the differences centre on two key issues.

The first is causality. Although the OECD does not distinguish between direct and indirect mobilisation, its methodology captures both, in effect, but only if causality can be demonstrated.

The second is attribution. The MDB methodology for direct mobilisation attributes all the private finance mobilised to the lead MDB, so no attribution is made to other MDBs, DFIs, or domestic public investors (such as NDBs) that co-finance the investment (World Bank, 2018b). In contrast, the OECD methodology attempts to consider the level of risk assumed by official investors. For certain instruments (such as shares in collective investment vehicles (CIVs) and direct corporate investments), the OECD methodology attributes a higher share of the private finance mobilised to official investors that are exposed to a higher level of risk. The MDB methodology does not take this into account (ibid.).¹⁷ There is also disagreement between the two 'camps' on the issue of double counting. The MDBs are of the view that their methodology provides a clear basis for attribution that avoids double counting (ibid.). The OECD believes that, while this is

clear for MDB direct mobilisation, it is unclear for indirect mobilisation (OECD, 2018c). In light of these concerns, caution should be exercised in interpreting the MDBs' indirect mobilisation figures. We report the MDB direct and indirect mobilisation figures separately.

Also problematic is the fact that DFIs, which have not previously reported to the DAC CRS,¹⁸ have started to adopt the MDB methodology (the EDFI adopted it in 2018).¹⁹ The MDBs are also in talks with the International Development Finance Club (IDFC) on adopting this methodology. As the number of DFIs using the MDB methodology expands, it will be important to get further clarity on the indirect mobilisation approach. Worked examples along the lines of those published by the OECD would help (OECD, 2018d).

Another important difference is the level of detail that is reported and the availability of public data underpinning the survey results. The MDB survey reports on a collective basis, with data disaggregated by MDB, by country income and region, and by infrastructure sector (World Bank, 2018a). Disaggregated data at country and project level are not publicly available due to client confidentiality agreements, which do not permit public disclosure of the terms of the financing package. However, semi-aggregated data underpinning the OECD survey *are* publicly available,²⁰ although it should be noted that not all DFIs reported in full to the OECD mobilisation survey, in part due to client confidentiality, but also because of the reporting burden, as the MDB and OECD definitions and methodologies are not aligned.

The challenges that this presents for a comprehensive and consistent picture of the landscape has been recognised and there have

17 The MDBs note that typically all parties invest on the same terms and there is no reason to think that the lead MDB bears less risk (IFC, 2018, unpublished assessment).

18 The OECD notes that some of these DFIs have not been reporting to the DAC CRS system (ibid.).

19 Of the 15 EDFI members 12 contributed to the 2018 MDB mobilisation survey.

20 The OECD survey is noteworthy in this regard, as the only publicly available survey that attempts to present a more disaggregated analysis accompanied by a semi-disaggregated dataset (Benn et al., 2017). See www.oecd.org/development/mobilisation.htm. However, it should be noted that the level of disaggregation is limited, as the data are not disaggregated by recipient and institution. Our understanding is that the survey respondents did not want data to be published at this level, although it is not obvious what commercial confidentiality issues would be breached by doing so.

been calls to align and harmonise the two methodologies. Discussions between the OECD and the MDBs have started, but the prospects for alignment and harmonisation do not look promising (OECD, 2018c). At a technical level, the OECD is working on case studies with the MDBs to better understand the differences in methodological approach, with a view to identifying where bridges can be built. These case studies should be made publicly available to help inform independent analysis and understanding, while efforts to align and harmonise frameworks should ideally involve a variety of stakeholders to inject independence into thinking on these critical issues.

2.3 Understanding the ‘input’: ODF investment

To understand the value for money of blended-finance approaches, we need to understand what ODF has been invested to mobilise private finance (the ‘input’) and how much this has cost (the subsidy). Data on what has been invested and the subsidy provided are not publicly available for the most part. For example, the aforementioned OECD and MDB surveys do not provide any data on what ODF has been invested (that is, MDB and DFI own-account resource and donor concessional funds). A review of the literature reveals that only one official survey, by the DFI Working Group on Blended Concessional Finance, has attempted to estimate the aggregate amount of ODF²¹ invested and the private finance it has mobilised. The results of the group’s first survey were presented at a highly aggregated level, with no supporting data made available (DFI Working Group, 2017). Its latest survey presents a more disaggregated analysis by sector, geography and instrument, but supporting data are still not available (DFI Working Group, 2018).

The OECD has made efforts to address this issue, with a modernisation of ODA that will enable the counting and reporting of investments in instruments to mobilise private finance (i.e. private-sector instruments, or PSIs) as ODA. Alas, its work has reached an impasse, as the DAC was unable to secure agreement on how to account for PSIs in ODA at its high-level meeting in October 2017. The outcome is an unsatisfactory situation, whereby donors can report PSI investment as ODA, even though the reporting rules have not been finalised. Donors will be able to report using either an ‘instrument’ or ‘institutional’ approach (OECD, 2018e).²² This will result in inconsistent ODA figures being reported by donors, with obvious adverse consequences for the quality of data and for transparency. These concerns, however, mask a more pressing problem. Previously, much DFI activity did not qualify as ODA, mainly because the investments were non-concessional. Now, however, these flows can be reported as ODA rather than OOF. This needs to be resolved as a matter of urgency, as it has the potential to undermine the very concept of ODA, the quality of ODA data and, hence, public trust.

Although disaggregated data underpinning the MDB survey are not disclosed, most (though not all) MDBs publish project-level data. The quality of the published data varies significantly from institution to institution, limiting the level of meaningful analysis that can be carried out. Furthermore, the data are not reported in standard form, as each institution has its own disclosure policy,²³ hindering comparability. As investment in blended finance is scaled up and these institutions increase their engagement in blended finance, a common international reporting standard for ODF investment and mobilised private finance would be extremely useful.

21 Split between MDB and DFI own-account resources, donor concessional funds and public contributions.

22 Under the ‘institutional’ approach, institutions can report on a cash-flow basis the ODA-eligible share of capital funding to their DFI as ODA; under the ‘instrument’ approach, institutions can report individual loan and equity investments at the transactional level on a cash-flow basis.

23 See Annex 2 for more discussion on this.

2.4 The urgent need for better data and transparency

Because of different definitions, varying survey coverage with respect to participating institutions and instruments, and different methods of measuring the mobilisation of private finance, we don't have a clear and consistent picture of how much private finance is being mobilised through the use of blended finance ('the output'). Likewise, we do not have a clear understanding of how much ODF is being invested, its cost ('the input') and what development impact the investment is having ('the outcome').

This situation is very much at odds with the blended-finance principles agreed by international donors at the OECD DAC²⁴ (OECD, 2018b) and by the MDBs and DFIs (DFI Working Group, 2017), which emphasise the importance of transparency and accountability. The gap between high-level pronouncements and practice needs to be urgently addressed by the donor-shareholders of the MDBs and DFIs and those on the OECD DAC.

Blended finance structures can be quite complex, comprising layered capital structures involving numerous institutions, several of which are private, and the use of various financial instruments. This complexity, combined with the fact that the transaction is commercial in nature, presents a challenge for data collection and publication, especially data on the embedded subsidy in each blended-finance investment. Many MDBs, DFIs and donors argue that commercial confidentiality restricts what disaggregated transactional data can be published, but a balance needs to be struck, as ODA is being used to subsidise private finance and there needs to be accountability and transparency of use.

There have been hard-won gains on transparency and accountability through the aid effectiveness agenda and these need to be preserved. ODA invested in blended finance should be subject to the same transparency rules as non-blended ODA. Ideally, blended-finance flows (input and output) should be reported by the MDBs, DFIs and donors to the OECD CRS system at a transactional level²⁵ (using the 'instrument' approach) to allow analysis of blended-finance flows by provider, destination country, sector and instrument, be they ODA or OOF. Furthermore, the OECD CRS should also facilitate analysis of these flows at investment level, as multiple actors may participate in a single investment.

On the sensitive issues of pricing, subsidisation and commercial confidentiality, several ideas deserve consideration. For MDBs and DFIs that report to the OECD using the 'instrument' methodology, the grant equivalent of individual transactions²⁶ could be reported using the OECD 'instrument' methodology, but publicly disclosed at a semi-aggregated level (for example, by country and sector for each MDB and DFI). For MDBs and DFIs that report to the OECD using the 'institutional' approach, the grant equivalent of transactions semi-aggregated by country and sector using the 'instrument' methodology could be reported to the OECD and publicly disclosed.²⁷ In this way, the actual terms of the investment are not reported or publicly disclosed, addressing confidentiality concerns.

In order to allocate and invest ODF most effectively (especially ODA), policy-makers need to understand the value of blended-finance approaches versus other forms of financing to achieve the same objective. At the granular level,²⁸ policy-makers, the taxpayer and those

24 G7 ministers, at their meeting in Toronto, also emphasised the need for a common understanding of blended finance and transparency in its use. They agreed to broaden awareness of the OECD DAC blended-finance principles (G7, 2018).

25 The 'institutional' approach currently allowed by the OECD removes transparency at the transactional level.

26 It would not be possible to calculate a grant equivalent for an equity investment.

27 MDBs and DFIs could be allowed to redact if there were only one transaction in a given country in a given year.

28 This report focuses on the perspective of public policy, but it is also critical for the private sector, to enable it to engage in blended finance (performance data).

affected by a project need to know how much was invested, what it cost (the subsidy), what ‘additional’ private finance was mobilised and its development impact,²⁹ disaggregated by provider,

country, sector and instrument. This, we would argue, is a basic data requirement and crucial amid the sensitivities to, and risks associated with, subsidising private investment.³⁰

29 So far, the evidence base on the development impact of blended finance is limited. Focus should also be turned to tracking and measuring development impact, as the objective of blended finance is to enable private investment in the SDGs and, hence, increase the overall development impact of public and private finance to deliver on global agendas, such as the SDGs and 2015 Paris Agreement.

30 Prime risks include distorting markets, crowding out the private sector and prioritising financial returns over development impacts.

3 ODI approach: scope and methodology

3.1 Definition and scope

The focus of this report is MDBs and DFIs, so we have tried to concentrate our analysis on blended concessional finance using their definition, identifying projects in their public datasets that have blended third-party or donor concessional resources with their own-account resources. However, data on concessional finance invested to mobilise private finance are almost impossible to obtain,³¹ so we have been unable to undertake a landscape analysis using the narrower MDB and DFI definition.

Because of this poor data availability, we have had to focus on a broader definition, closer to that of the OECD. Even so, we have limited our focus to the use of the official component of development finance, due to the lack of comprehensive and consistent data on private development finance. We have, therefore, confined our analysis to the strategic use of official development finance to mobilise additional private finance for development purposes.³²

It should be noted that by delineating our focus in this way, we are limiting the scope of our focus to what is determined by data availability

rather than a conceptual view on the definition of blended finance. Like the OECD approach, it will identify MDB and DFI private-sector investment operations funded purely by MDB and DFI own-account resources as blended finance. From an MDB and DFI perspective, this will overestimate the amount of private finance mobilised through blended finance.

While we understand the rationale behind the differing definitions, we believe the most useful definition of blended finance should be guided by public policy concern over the effective use of ODF and, therefore, focus on the public subsidy³³ provided to mobilise additional private finance for development. This chimes with the MDB, DFI and UN definition, which focuses on blended concessional finance (which subsidises private investment below market terms) and gives a nod to the OECD definition by including MDB and DFI own-account investment activity, where explicit and/or implicit subsidies are purely funded by MDB and DFI own-account resources. It stops short of including private development finance, however. Data on subsidies to mobilise private finance are not disclosed by MDBs, DFIs and donors, so it is not possible to analyse blended finance through this lens.

31 We were able to identify the IFC's concessional projects. The IFC publishes a list of donor or third-party concessional funds that it uses to blend, which we confirmed with the IFC. We then reviewed every project description in the IFC database to identify whether any of these funds had been used at project level. However, our analysis was constrained by the fact that project descriptions did not disclose the amount of concessional finance invested, just that it was used.

32 This is essentially the official-finance subset of the OECD definition of the input side and includes concessional and non-concessional capital (MDB and DFI own-account resources). Our work excludes analysis of private development finance.

33 We borrow the definition of 'subsidy' from Carter (2015: 5), who defines a subsidy as 'any intervention by a public development agency, at the project level, that has the effect of raising expected risk-adjusted returns for private investors.'

3.2 Data

To analyse the private finance that has been mobilised (the ‘output’), we rely on the OECD data,³⁴ as this is the most disaggregated dataset publicly available. Still, it is not ideal: it is not comprehensive, covering only five instruments, and the data are semi-disaggregated.

There are no readily available data to help us understand the ODF that has been invested (the input). We have, therefore, built our own database of ODF committed by the largest MDBs and DFIs engaged in mobilising private finance (their own-account resources).³⁵ We identified 11 institutions for study, but data were only available for 9 of them. Our data were drawn from those reported publicly in the institutions’ project-level datasets. Unfortunately, the quality and availability of data vary considerably from institution to institution and none has published a complete public dataset on private finance mobilised at project level.

It is important to note that our data and analysis focus on a subset of the total

blended-finance universe, as we do not cover all MDBs and DFIs, and exclude NDBs and China. Our selected MDBs and DFIs mobilised 77% of the total private finance overall and 85% of total private finance in LICs between 2012–2015, according to the (2016) OECD mobilisation survey (which excludes China) (Benn et al., 2017), so we have covered the main traditional international actors.

More information about the quality of the institutional datasets and the publicly available data we have used to build our database can be found in Annex 2. We recognise that our dataset is not perfect, but in the absence of publicly available, good-quality, disaggregated comparable data, we believe our approach is sensible and that the data on ODF committed are in the right general area.³⁶ We also believe our analysis raises important policy issues for further analysis and discussion by practitioners and policy-makers, highlighting the urgent need for alignment of conceptual frameworks, better-quality data and transparency.

34 The public OECD mobilisation survey dataset (Benn et al., 2017) contains disaggregated data on recipients, but these are not linked to the institutions. From communication with the OECD, we were able to obtain a more disaggregated dataset (OECD, 2017), which does contain information on which institutions mobilise in which recipient countries. However, these data are not available by year or by agency. Various sections of our analysis require the use of one dataset over the other, leading to some discrepancies between numbers. Throughout the analysis, we have highlighted which dataset is used by referencing Benn et al. (2017) or OECD (2017).

35 Data on disbursements and outstanding amounts are not generally available, so we have used commitment data.

36 We compared the sum of the project-level commitment data for each institution with the aggregate sums reported by the institutions in their annual reports. The sums were broadly similar, so we were reassured about the completeness of our dataset and our analysis of total figures. Standardisation of the datasets in terms of instrument, sector classification or poor data may result in some misclassification of instruments and/or sectors.

4 The big blended-finance push

Key findings

- There is a strong conceptual underpinning, rooted in public economics, supporting the argument for donors to increase ODF investment in blended finance. On balance, we would expect to see more public subsidy funded by blended concessional finance in LICs than in MICs, given the more pronounced existence of market failures in LICs.
- Private investment is set to play a critical role in financing the achievement of the SDGs. The international community has, therefore, shifted its emphasis to the use of ODA as a catalyst for mobilising additional private finance.
- At the bilateral level, ODA reporting rules are changing to allow donors to report as ODA their capitalisation of DFIs or their investment in instruments for mobilising private finance. In future, donors will be able to report significant amounts of private finance crowded in using ODA.
- At the multilateral level, MDBs are tasked with better utilising their resources to increase the mobilisation of private finance, and targets have been set to increase mobilisation by the G20.
- There is a risk, however, that this shift in the policy landscape and the ensuing rise in investment of ODA in blended finance will not deliver for LICs. It may steer ODA away from LICs, as it is easier to mobilise private finance in more stable and mature markets. Mobilisation targets may also shift emphasis away from ensuring financial additionality and prioritising development impact.
- Donors need to understand and manage these risks to ensure that blended finance does not exacerbate the poor targeting of ODA and that investments are better targeted to help support LICs that cannot finance the eradication of extreme poverty from their own resources.

4.1 The argument for blended finance

Blended finance seeks to unlock private commercial investment in SDG outcomes that would not happen otherwise. It does this by using ODF to provide a subsidy to bring the risk-adjusted rate of return on investment in line with the market, increasing the allure of the investment from a private commercial investor perspective.

The rationale behind this approach is firmly rooted in public economics. Markets are ‘imperfect’ and the presence of market failures, which are especially pronounced in developing countries, results in sub-optimal³⁷ levels of private investment and provision of goods and services, so the public sector intervenes to correct for the market failure. One form of public intervention to correct for the underprovision of socioeconomic beneficial goods and services is a public subsidy. Blended-finance approaches,

³⁷ From society’s point of view. This argument focuses on production externalities.

which subsidise the private sector, can be justified when they make high-impact development investments financially viable (essentially, those projects where the socioeconomic returns exceed the private commercial returns).³⁸

The level of the public subsidy will vary with the level of market development. At one end of the spectrum, where markets do not exist, pioneering investments are made to create markets (for example, in LICs and fragile and conflict-affected states) where there is a greater need for public subsidy, as the risks are likely to be too great for private investors. As the market develops, however, there is less need for public subsidies, so commercial forms of finance become more important.³⁹ There is, thus, a dynamic logic to blended finance, whereby blended finance should successively enter new markets and sectors (when socioeconomic returns exceed private returns) and then exit established blended-finance markets when commercial investors eventually take over in full (when private returns exceed the benefits to society). This rationale sits at the core of the argument made by proponents of blended finance for the use of subsidies.⁴⁰ Viewed in this way, the more pronounced the degree of market failure, the higher the level of subsidy funded by ODF (in other words, greater concessionality). As market failures are more pronounced in LICs, one would expect to see higher levels of subsidy in these countries (greater use of concessional funding) than in MICs.

4.2 Increased ODA investment in blended finance due to policy changes

Blended-finance approaches and the use of PSIs have been used in the climate-finance arena and at national level (for example, by NDBs) for a number of years. The approach is not new in and of itself. What *is* new is the increasing interest of donors in investing ODA in these approaches, and a shift in emphasis from ‘public–public’ blending to ‘public–private’ blending,⁴¹ which places a greater emphasis on mobilising commercial finance and the lofty ambition assigned to it in shifting the development financing needle from ‘billions to trillions’.

4.2.1 Fundamental policy changes

Fundamental shifts in the policy landscape and supportive policy signals will result in increased investment of ODA in blended-finance approaches.

The **Addis Ababa Agenda for Action** (UNDESA, 2015: 27) recognised the central role of private investment and, for the first time, the potential of blended finance, assigning an important role to the catalytic use of ‘international public finance, including ODA to mobilise private finance’. We see a fundamental shift in the development finance landscape, with the international community giving MDBs and DFIs a key role in blending ODA ‘to scale up financing for development’ (ibid).

The **2015 Paris Agreement** (United Nations, 2015), where 195 countries submitted national

38 See Carter (2015) for a more detailed exploration of why donors may choose to subsidise the private sector and Warner (2013) for an exploration of when this approach may be justified.

39 The idea that the level of public subsidy should fall in a given market over time is central to the DFI blended concessional finance principles (principle three on commercial sustainability) (DFI Working Group, 2017) and the OECD blended finance principles (principle two on designing blended finance to increase the mobilisation of private finance) (OECD, 2018b).

40 This is the case when it is expected that full commercial markets can be developed over time and that the market will supply the optimal level of goods and services. This will not always be the case. There are some markets where the subsidy is more permanent, as demonstrated by the existence of widespread subsidies in many OECD markets, such as public transport.

41 Public–public blending essentially mixes concessional ODF with non-concessional ODF to create a new form of slightly less concessional ODF. Much EU blending was in this form, but the emphasis has shifted to public–private blending, as evidenced by the new European Fund for Sustainable Development (EFSD) and the EU’s new external investment plan.

climate action plans outlining the investment required to keep global warming below 2°C, saw developed countries reiterate their intention to scale up climate financing to mobilise \$100 billion per annum by 2020, and extend this to 2025, to help developing countries deal with climate change. Given the interdependence of the climate-change adaptation and mitigation agenda and the SDGs, blended-finance approaches are likely to play a significant role in crowding in the additional private finance required to meet these internationally agreed goals.

Changing incentives at the bilateral level.

Significant efforts are underway in the OECD DAC to build the case for blended finance and institutionalise the approach. ODA reforms by the OECD DAC (OECD, 2017) and the development of the new Total Official Support for Sustainable Development (TOSSD)⁴² metric will incentivise increased investment of ODA in blended-finance approaches, in addition to reporting investment in blended finance as ODA, as donors will be able to report significant amounts of private finance mobilised in TOSSD. As traditional donors run up against budget constraints, investing ODA in this way will be attractive, as it will be easier to align to domestic political and economic interests in the context of rising ‘aid nationalism’ (Gulrajani, 2017). The OECD DAC has also agreed blended-finance principles, which aim to guide the use of ODF and which set out the steps required for blended finance to achieve to scale and impact (OECD, 2018b).

Changing incentives at the multilateral level.

A more effective multilateral finance system is high up the G7 and G20 political agendas. MDBs have been tasked with exploring balance-sheet optimisation operations to increase mobilisation

and there have been calls to set MDB and DFI mobilisation targets (Blended Finance Taskforce, 2018b). Indeed, in 2017, the G20 endorsed a target to increase MDB mobilisation of private finance by 25%–35% by 2020.⁴³ MDBs have taken up the gauntlet and formed a working group, which has sought to harmonise blended-finance approaches across the MDB system, for example, through the adoption in October 2017 of the Enhanced Principles for Blended Finance⁴⁴ and through the publication of the MDB global toolbox to advance private-sector investment (IFC, n.d.). The group has also developed a methodology to estimate the amount of private finance the MDB system is mobilising and has published two reports, discussed in section 5.1.

4.2.2 Increased investment of ODA in blended finance

Increased bilateral investment in DFIs. At the bilateral level, blended-finance approaches are mainly channelled through DFIs and there is growing interest in their role and how they can mobilise ‘additional’ private commercial finance above and beyond their own-account resources. We expect this increased interest and intention to scale up investment in blended finance to play out in the establishment of new DFIs, such as FinDev Canada, established in January 2018, and the planned new US International Development Finance Corporation (US IDFC). We also see increased investment in DFIs – for example, the additional £3.5 billion capitalisation of the CDC Group, announced in October 2017, corresponding to around 8% of the UK’s ODA budget for the next five years.⁴⁵ As noted, donors will count this investment as ODA using either the ‘institutional’ or ‘instrument’ method agreed by the OECD DAC as part of efforts to reform ODA and incentivise its use as a catalyst.

42 See www.oecd.org/dac/financing-sustainable-development/tosssd.htm.

43 The Hamburg Principles and Ambitions on crowding in private finance developed by the G20 International Financial Architecture Working Group (G20 Germany, 2017).

44 See DFI Working Group (2017). This builds on IFC (2013).

45 The UK will report the £3.5 billion capitalisation as ODA to the OECD CRS under the ‘institutional’ approach. It is estimated that CDC will ‘receive up to 8% of the UK ODA budget or GBP 600-700 million per year on average over the next 5 years’ (OECD, 2018f: 3).

Increased multilateral investment in blended finance. At the multilateral level, we expect a step up in blended-finance investment, as demonstrated by the IFC's new \$5.5 billion capital injection, announced in April 2018. We also see the establishment of new multilateral windows, such as the \$2.5 billion IDA Private Sector Window (PSW) in July 2017,⁴⁶ which aims to mobilise \$6 billion–\$8 billion in additional private investment in IDA-only countries, with a focus on fragile and conflict-affected states, and funds such as the EFSD in September 2017 and the new EU External Investment Plan, which aims to mobilise €44 billion of extra public and private investment.

4.3 Risk of leaving the poorest countries behind

This increased investment of ODA in blended finance runs the risk of diverting ODA allocation away from LICs and the investment in health, education and social protection needed to eradicate extreme poverty. This risk essentially emanates from the setting of mobilisation targets in the absence of a coordinated framework.

First, mobilisation targets will be easier to achieve in more stable and mature markets, due to their lower levels of perceived or actual risk, greater ease of doing business, etc. This is likely to result in a further concentration of MIC and hard-sector financing in MDB and DFI portfolios at the expense of investment in more challenging countries and sectors with higher financial and development additionality. Some argue that this risk can be reduced if there is careful calibration of targets across the MDB and DFI system, and within the institutions themselves, but there are potential pitfalls.⁴⁷

Second, mobilisation targets run the risk of diverting MDB and DFI focus away from financial additionality, as these targets may encourage MDBs and DFIs to provide unnecessary subsidy and invest in projects that the private sector would have invested in on a standalone basis. Focus is also likely to be shifted away from development impact, as it is generally harder to mobilise commercial finance for projects that prioritise strong developmental benefits.

This risk is a real concern. The eradication of extreme poverty lies at the core of the SDG agenda, yet ODI's latest research finds that the allocation of Country Programmable Aid (CPA)⁴⁸ is not well targeted at countries that cannot afford to finance the eradication of extreme poverty from their own domestic resources (in other words, all LICs, except Tajikistan, and some LMICs). The research finds that even though LMICs have over 300 times the potential revenue per person living in extreme poverty,⁴⁹ they receive 10 times more CPA per person living in extreme poverty than an LIC. For LMICs, this falls to 10 times the potential revenue and 7 times more CPA per person living in extreme poverty. Yet the financing gap is especially acute in LICs, where 96% of the countries that are 'severely challenged' and cannot afford even half the investment needed in health, education and social protection from domestic resources, even if they raised taxation levels to the maximum level, are LICs (Manuel et al., 2018).

Comparing ODA flows and blended finance in more detail, we can see that far less blended finance is aimed at the poorest countries (Figure 1). While ODA per capita is higher in LICs, the opposite is true for blended finance. If we assume the purpose of ODA is to eliminate poverty and look only

46 The IDA18 replenishment of \$75 billion included a 3% allocation of \$2.5 billion over three years to create the IDA18 IFC MIGA PSW, which started operation on 1 July 2017. The objective of the window is to support the mobilisation of private-sector investment in IDA-only countries, with a focus on fragile and conflict-affected states, by supporting IFC- and MIGA-led transactions.

47 For more on potential pitfalls of setting mobilisation targets, see Carter (2018).

48 CPA is used as a proxy for aid that is spent in recipient countries. As such, it excludes donor administration costs, debt relief and humanitarian aid.

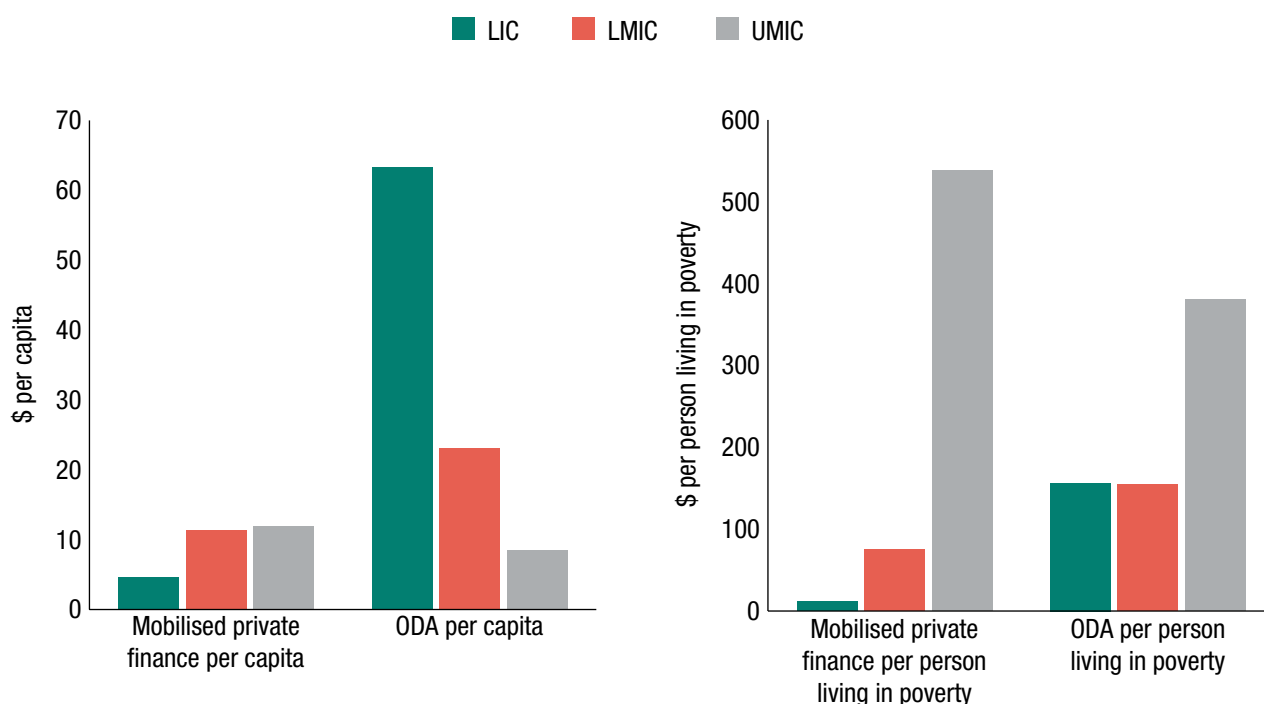
49 The report identifies 48 countries that are unable to fully fund core poverty eradication expenditure (such as health, education and social protection) from their own domestic revenue; 31 are LICs and 17 are LMICs.

at those people living in poverty, the trend is the inverse of what we would expect for both flows – the poor populations in UMICs receive far more than the (larger) poor populations in LICs and LMICs.⁵⁰ This pattern is much more pronounced for blended-finance flows. While a person living in poverty in MICs receives 2.4 times more ODA than a person living in poverty in LICs – a ratio of 1:2.4 – they receive 47 times the amount of blended finance – a ratio of 1:47.

As donors increase their investment of ODA in blended finance, they will need to be clear on the value for money of blended finance in different countries and sectors. It will be crucial to ensure that the resulting change in ODA allocation is not at the expense of those countries who need ODA the most.

It is still early days, however, and data limitations have meant that we have been unable to quantify how much ODA has been invested in DFIs and PSIs, or the destination countries of investment. We have, therefore, been unable to quantify the risk of increased investment of ODA in blended finance diverting traditional ODA investment away from LICs. Although blended concessional finance constitutes a small part of MDB and DFI private-finance operations, it had grown from approximately 5% in 2014–2016 (DFI Working Group, 2017) to approximately 9% in 2017 (DFI Working Group, 2018). This will be the subject of future research once ODA reform by the OECD DAC has been agreed and fully implemented by all MDBs and DFIs – something that is likely to take a few years yet.

Figure 1 Comparison of ODA and blended finance (per capita and per person living in poverty)



Note: Poverty measured using the World Bank's \$1.90 per day at 2011 purchasing-power parity.

Source: Mobilised private finance data (2012–2015) (Benn et al., 2017); ODA (2015) data from OECD CRS; poverty data (2013) from World Bank PovcalNet (World Bank, 2017a).

⁵⁰ This reflects the fact that while (1) the total population in MICs is larger than that of LICs, and (2) the total number of poor people living in MICs is larger than LICs, the share of the total population of LICs living in poverty is much higher than in MICs.

5 The potential of blended finance: time for a reality check

Key findings

- Estimates of private finance mobilised through blended finance by MDBs, DFIs and donors in LICs and MICs range from \$3.3 billion (DFI Working Group, 2018) to \$27 billion annually (Benn et al., 2017). This rises to \$71.1 billion if we use total direct and indirect mobilisation reported by MDBs (World Bank, 2017b).
- This is based on investment of ODF of around \$2.2 billion to \$121 billion annually. The large range in the mobilisation and commitment figures reflects the different scopes of the surveys.
- Overall, global leverage ratios for MDBs and DFIs as a whole are very low, ranging from 1:0.14 to 1:1.3.⁵¹ This rises to 1:1.5 if we use total direct and indirect mobilisation reported by MDBs.
- ODI estimates that \$1 of public investment mobilises just \$0.37 of private investment in LICs, \$1.06 in LMICs and \$0.65 in UMICs. Leverage ratios are lowest for infrastructure in LICs and MICs.
- Despite practitioners having the knowledge, we do not know how much it costs to mobilise private finance or, consequently, the value for money of blended finance, as levels of MDB and DFI subsidy are not reported. Ideally, leverage ratios would be calculated based on the grant equivalent of the ODF invested. Coupled with metrics on impact, this would give policy-makers a better understanding of the potential and value of blended finance.
- Low financial leverage ratios raise three issues: (1) policy-makers need to recalibrate their expectations of the potential of blended finance, (2) MDBs and DFIs need to get better at mobilising private finance; fundamental changes are required, and (3) there is a crucial need to understand the development additionality of blended-finance investment to assess its value for money compared with other forms of financing to achieve stated development objectives.

‘Billions to trillions’ has become synonymous with blended finance and the mobilisation of private finance for development, despite its broader original context (World Bank, 2015). Indeed, according to the Blended Finance Taskforce (2018b: 13), ‘blending, done well, is

one of the best solutions to turn billions of ODA aid money into trillions of investment capital for the SDGs’.

Our research suggests that while there is an appreciation of the limitations of blended finance at the operational level within the MDBs

⁵¹ Calculated as total private finance mobilised against ODF invested, expressed as a ratio of \$1 of ODF invested. These ratios have been calculated using the face value of the ODF investment.

and DFIs, this appreciation is more limited in the wider financing-for-development policy discourse. Experience to date suggests a reality check is required to calibrate the policy debate and temper expectations and bridge the current disconnection between policy rhetoric and the operational reality: ‘billions to billions’ might be a more plausible goal.

5.1 How much private finance is being mobilised?

As discussed in section 2, the lack of definitional and methodological harmonisation at the global level makes it difficult to estimate the scale of blended finance. Most attempts focus on the amount of private finance mobilised, with little attention paid to how much ODF has been invested and its cost. Three recent official surveys of note have been undertaken by the OECD, a group of MDBs and the DFI Working Group on blended concessional finance.⁵² These surveys estimate the range of private finance mobilised in LICs and MICs at anywhere from \$3.3 billion⁵³ to \$27 billion per annum, increasing to \$71.1 billion per annum if indirect MDB mobilisation is included.⁵⁴ This is modest compared with ODA flows of \$146.6 billion in 2017 (OECD, 2018g) and positively tiny compared with the estimated SDG financing gap of \$2.5 trillion per annum.

At this juncture it is important to note that we are focusing on private finance mobilised and reported by MDBs, DFIs and donors. This is distinct from the wider ‘catalytic’ impact of MDB and DFI investment created, for example, through technical assistance, policy support,

knowledge transfer and demonstration effects. These ‘catalytic’ effects are challenging to measure in a consistent manner and are not yet reported by MDBs and DFIs, but they are likely to be particularly important for LICs.

5.1.1 OECD mobilisation surveys

The OECD has conducted multiple surveys of DAC donors and multilateral institutions to measure the total private finance mobilised by the investment of ODF in blended finance. The most recent 2016 survey estimates that a total of \$81.1 billion was mobilised in 2012–2015, with \$27 billion mobilised in 2015 (Benn et al., 2017).⁵⁵

The measurement methodology underpinning these surveys is a work in progress. The 2016 survey covered five instruments: guarantees, syndicated loans, shares in CIVs (such as private equity funds), direct investments in companies and credit lines. The OECD is developing its instrument methodology to include project finance (public–private partnerships), standard loans and grants in private-sector co-financing schemes. Once these methodologies are approved, the survey coverage will be deemed comprehensive.

The OECD’s 2016 survey is based on the responses of 71 DAC donors and multilateral institutions. It underestimates the amount of private finance mobilised, due to its instrument coverage and the fact that some important non-DAC institutions, such as the Islamic Development Bank (IsDB), did not respond. The IsDB mobilised a total of \$4 billion in private finance in LICs and MICs in 2017 (\$67 million in direct mobilisation and

52 Other sources of data on blended finance include the convergence dataset. The World Economic Forum (2016) also conducted a survey in 2016.

53 Using the strict DFI Working Group definition which focuses on the use of concessional finance. This is at the lower end of the scale, as it concentrates solely on blended concessional finance, which makes up a relatively small percentage of the total volume of all MDB and DFI private-finance mobilisation activities.

54 In an effort to understand the potential of blended finance, further data and analysis on the type of private investor being mobilised would be very useful. Unfortunately, this data is not available.

55 In February 2019 the OECD released high-level mobilisation data for the period 2012–2017. It reports that \$152.1 billion was mobilised from the private sector in 2012–2017. See OECD website (www.oecd.org/dac/financing-sustainable-development/development-finance-standards/mobilisation.htm).

\$3.9 billion in indirect mobilisation) (World Bank, 2018a).

5.1.2 MDB mobilisation surveys

MDBs have also carried out surveys to estimate the amount of private finance they have mobilised. As noted previously, MDBs would not consider the mobilisation they report to be blended finance, only that private finance mobilised through blended concessional finance. In the surveys, MDBs report total private co-financing mobilised, divided into direct and indirect mobilisation. In the following paragraphs, we cite the reported direct mobilisation figure and note the total including indirect mobilisation in italics and in brackets (for reasons explained in section 2.2).

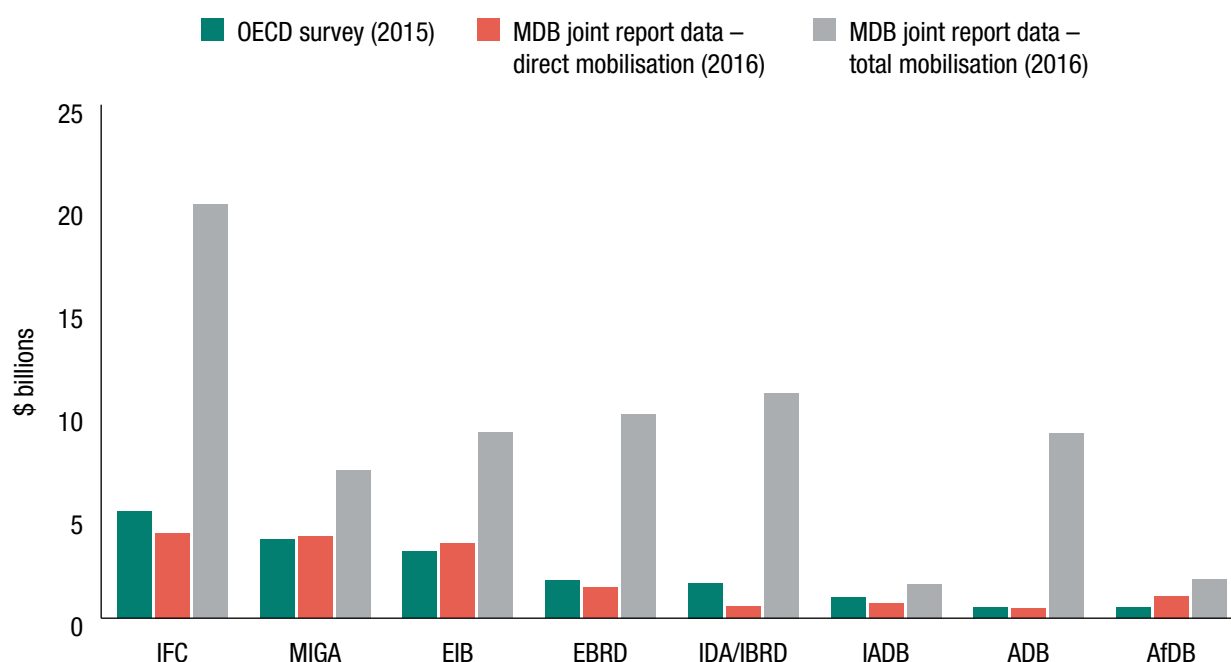
The first survey published in 2017 estimates that the MDBs directly mobilised \$49.9 billion (*\$163.6 billion*) of private finance in 2016

(World Bank, 2017b).⁵⁶ It should be noted, however, that most of this – \$33.4 billion (*\$92.5 billion*) – was mobilised in high-income countries (HICs).⁵⁷ The amount mobilised in LICs and MICs totalled \$16.5 billion (*\$71.1 billion*) in 2016.

The second survey published in 2018 included for the first time the results of 12 European DFIs.⁵⁸ The report estimates that MDBs and DFIs directly mobilised \$52 billion (*\$163.5 billion*) of private finance in 2017 (World Bank, 2018a). If we again exclude operations in HICs, which totalled \$32.9 billion (*\$104.1 billion*), they directly mobilised \$19.1 billion (*\$59.4 billion*) in 2017. If we strip out DFIs, the direct private finance mobilised by MDBs was \$18.1 billion (*\$55.9 billion*).

As discussed in section 2.2, the MDB survey uses a different methodology to the OECD survey, covering all private-sector instruments.

Figure 2 Private finance mobilised by MDBs



Note: World Bank (2017b) data exclude investments in HICs. OECD survey data for EIB are for non-EU recipients only. Source: Benn et al. (2017); World Bank (2017b).

⁵⁶ Long-term financing (tenor greater than one year) excludes facilities such as trade finance and working-capital facilities.

⁵⁷ Of this, \$32 billion (*\$50.2 billion*) was mobilised by the EIB in EU countries.

⁵⁸ The EDFI has adopted the MDB methodology for measuring the mobilisation of private finance, with 12 of its 15 members reporting their results for 2017.

It includes the largest MDBs: the AfDB, ADB, Asian Infrastructure Investment Bank (AIIB), European Bank for Reconstruction and Development (EBRD), EIB, Inter-American Development Bank (IADB), IsDB and the World Bank Group. Disaggregated data underpinning the report are not publicly available, but the annex to the MDB survey does contain aggregated data by institution, by country income classification and by infrastructure sector.

By way of illustration, Figure 2 plots the 2015 data of the OECD survey against the MDB survey. One can see material differences in the reported amounts of mobilised private finance. However, the two surveys cannot be directly compared, as explained in section 2.2.

5.1.3 DFI Working Group surveys

The DFI Working Group on Blended Concessional Finance, consisting of eight MDBs and the EDFI, has conducted two surveys using the narrower MDB and DFI definition of blended finance, which focuses on blended concessional finance. It should be noted that this is a very small percentage of all MDB and DFI private finance-mobilisation operations.

The first survey, published in 2017, found that \$1.5 billion in concessional finance was invested alongside \$5.2 billion of MDB and DFI own-account finance in 2014–2016, mobilising \$8.5 billion in private investment, which translates into around \$2.8 billion⁵⁹ per year (DFI Working Group, 2017). The report is highly aggregated, reporting only total volumes of ODF invested, split by concessional and own-account resources and total private finance mobilised. It also breaks down the ODF invested by instrument. The disaggregated data underpinning these findings are not publicly available.

The second survey, published in 2018, reported \$1.2 billion in concessional finance invested alongside \$3.9 billion of MDB and DFI own-account finance in 2017, mobilising around \$3.3 billion in private finance (DFI Working Group, 2018). The report is more useful for analysis purposes than the 2017 report, as it breaks down the financing by volume, instrument, sector and geography, although the disaggregated data underpinning the report are not publicly available.

5.2 Low leverage ratios and the need to temper expectations

Leverage ratios are often at the core of donor arguments for increasing the investment of ODA in blended finance. They are often used by policy-makers as a proxy indicator of the success of blended-finance investment (the higher the ratio, the more development finance there is to invest in the SDGs).⁶⁰ The importance of leverage ratios should not be overstated, however, as there are a number of interpretive issues to be aware of, so caution should be exercised when using them.

1. Leverage ratios are simple arithmetic ratios that do not imply causality, so financial leverage should not be interpreted as a proxy measure of financial additionality. Indeed, assessment of financial additionality is complex and challenging, not least because of the lack of counterfactual, and is beyond the scope of this report.⁶¹ High leverage ratios are not, therefore, automatically synonymous with high levels of additional financing. Indeed, they may signal little additional capital, as high private-finance multiples may suggest that the private investment would have materialised anyway, without public support.

59 Calculated as total project value of \$15.2 billion, less \$6.7 billion of concessional finance and DFI own-account resources, divided by three.

60 Some argue that blended finance does not necessarily increase the size of the development financing pie. For example, Carter (2015) argues that in the absence of binding borrowing constraints on donors, donors could create the same financing package at the same cost to the taxpayer, so no additional finance has been mobilised.

61 See Pereira (2015) for an overview of the literature on the additionality of using ODA to leverage private investment, as well as Carter (2018), who examines potential evidence of additionality and concludes that concrete evidence of additionality is elusive.

2. Financial leverage ratios say nothing at all about development additionality and nothing about the broader catalytic effects of blended finance.
3. Measurement is highly problematic and a challenge. It is more of an art than a science given the lack of good-quality comparable ‘input’ and ‘output’ data, the plethora of definitions and the various measurement methodologies. Thus, it is not possible to calculate financial leverage ratios with any degree of precision.

Essentially, what we are interested in is the multiplication effect of ODF – in other words, the ability of ODF to mobilise a larger multiple of private capital – and how much it costs to mobilise this multiple (the public subsidy). This, together with metrics on impact, can help shed light on the potential and value for money of blended finance. There are several ways in which leverage can be defined and measured. The most informative metric for policy-makers would be a measure of the leverage effect of the public subsidy (or how much private finance is being mobilised per dollar of public subsidy).⁶² This would involve calculating the grant equivalent of the investment as a proxy measure of the subsidy and calculating leverage based on the grant equivalent of the ODF invested. Unfortunately, there are no publicly available data on the grant equivalents (subsidies) provided by MDBs and DFIs, so we focus instead on the ratio of public investment (as proxied by MDB and DFI own-account commitments) to private finance mobilised. So, for example, if \$1 of MDB and DFI investment led to \$2 of private capital being invested, the leverage ratio would be 1:2.

5.2.1 Global leverage-ratio estimates

A review of the literature identifies two attempts to calculate very rough estimates of global

leverage ratios by the Blended Finance Taskforce and the DFI Working Group on Concessional Blended Finance. Attempts to estimate global leverage ratios have used total MDB and DFI commitments as a measure of public effort (in other words, investment of ODF) and are calculated at highly aggregated levels.

Table 2 summarises the main sources of data on mobilisation and shows the range of leverage ratios calculated at global level.

The Blended Finance Taskforce (2018b) report calculates individual MDB leverage ratios, as well as a leverage ratio for the MDB system, using the total value of MDB commitments, which it estimates at around \$207 billion in 2016, and finds a low leverage ratio of 1:0.8. Using the Taskforce’s figures, we strip out HIC operations, adjusting for EIB EU operations,⁶³ and estimate MDB system leverage ratios for direct and total mobilisation (see Table 2), which range from 1:0.14 to 1:0.7.

The Blended Finance Taskforce report also calculates leverage ratios for individual MDB PSWs using the value of dedicated PSW commitments only, which it estimates at a total of \$40 billion in LICs and MICs in 2016.⁶⁴ The Taskforce finds that the leverage ratio nearly doubles to 1:1.5. As discussed in the methodology note to this report (Annex 2), this is likely to overestimate MDB efforts, as not all of their activities target mobilisation, so the report and our estimates may slightly underestimate system leverage ratios. It should also be noted that this study only includes MDBs, so excludes any donor efforts on the part of bilateral donors or their DFIs.⁶⁵

Another attempt has been made by the DFI Working Group on Blended Concessional Finance, which focuses on the leverage effect of blended third-party or donor concessional finance (i.e. the amount of MDB and DFI own-account and private finance leveraged as

62 For a technical discussion, please see Carter (2018).

63 As a proxy for HICs, 96% of the mobilisation reported in HICs was mobilised in the EU by the EIB.

64 EIB EU operations are excluded.

65 For a sense of scale, the 2016 OECD mobilisation survey estimates that around 36% of the private finance mobilised is drummed up by bilateral donors and their DFIs (Benn et al., 2017).

Table 2 Summary of mobilisation data sources and implied leverage ratio

Source	MDB/DFI own-account commitment (annual average for years in brackets)	Private finance mobilised (annual average for years in brackets)	Leverage ratio (ratio of ODF to private finance mobilised)
OECD mobilisation survey (2016) (MDBs and DAC donors)	Not surveyed	\$20.2 billion (2012–2015)	Not possible to calculate
MDB mobilisation survey (2018) (MDBs and EDFI)	Not surveyed	\$19.1 billion direct mobilisation (2017) (MDBs excluding HIC operations) \$59.4 billion total mobilisation (2017) (MDBs excluding HIC operations)	Not possible to calculate
Blended Finance Taskforce: better finance, better world (2018b) (MDBs only)	\$121 billion ⁱ (2016) (MDBs excluding EIB EU operations)	\$17 billion direct mobilisation (2016) (MDBs excluding EIB EU operations)	1:0.14
	\$121 billion ⁱ (2016) (MDBs excluding EIB EU operations)	\$82.3 billion total mobilisation (2016) (MDBs excluding EIB EU operations)	1:0.7
	\$39.6 billion (2016) (MDB PSWs excluding EIB EU operations)	\$15.5 billion direct mobilisation (2016) (MDB PSWs excluding EIB EU operations)	1:0.4
	\$39.6 billion (2016) (MDB PSWs excluding EIB EU operations)	\$58.9 billion total mobilisation (2016) (MDB PSWs excluding EIB EU operations)	1:1.5
DFI Working Group ⁱⁱ (MDBs and DFIs)	\$2.2 billion ⁱⁱⁱ (2014–2016)	\$2.83 billion (2014–2016)	1:1.3
	\$5.5 billion (2017)	\$3.3 billion (2017)	1:0.6
ODI dataset (9 focus institutions)	\$23.1 billion (2013–2016)	Collection not possible	Not possible to calculate
ODI estimate ^{iv}	\$21.4 billion (2013–2015)	\$16 billion (2013–2015)	1:0.75

Notes: (i) We assume 10% of EIB operations are in non-EU countries. EIB works in over 150 non-EU states which receive around 10% of EIB funding. See EIB website (www.eib.org/en/about/key_figures/index.htm). (ii) We calculate this as the ratio of public investment (i.e. concessional and own-account resources) to private investment. (iii) Concessional resources and own account. (iv) Combining our dataset with the OECD mobilisation survey for nine selected institutions.

a result of using the donor and or third-party concessional finance). These ratios will be higher than those reported in Table 2 and what we have calculated, as they include MDB and DFI own-account investment as finance leveraged. For example, the DFI Working Group reports that \$1 of concessional donor support mobilises \$10 from MDBs and DFIs and the private investor (in other words, a leverage ratio of 1:10) (DFI Working Group, 2017). For 2018, this ratio falls to 1:6 (DFI Working Group, 2018).

5.2.2 ODI disaggregated leverage-ratio estimates

To have a more nuanced understanding of the potential in different countries and sectors, we need to move beyond these global estimates and understand leverage ratios at a more granular level. We can use our disaggregated blended-finance commitment database to explore this. Caution should, however, be exercised in interpreting our disaggregated leverage ratios, as two different data sets have been used to compute it, with different methodologies for collecting and analysing data. Furthermore, we have only looked at a sample of nine MDBs

and DFIs. The exercise is presented by way of illustration, to stimulate discussion about the potential of blended finance and to highlight the need for better data and more transparency to enable more precise analysis. It is the picture the data paint in the context of the ‘billions to trillions’ agenda that is important, rather than the necessarily imprecise methodology used.

Our data show that commitments invested in projects aimed at mobilising private finance by our nine focus MDBs and DFIs totalled an annual average of \$21.4 billion in 2013–2015. Combining the findings of our collated dataset and the disaggregated mobilisation numbers of the OECD mobilisation survey,⁶⁶ we can get a rough estimate of global leverage ratios. Using

the annual average for 2013–2015 and limiting the scope to our nine focus MDBs and DFIs, we find that \$64.2 billion of MDB and DFI commitments mobilised a total of \$47.9 billion in private finance, resulting in a leverage ratio of 1:0.75.⁶⁷ Our overall ratio is roughly similar to that calculated by the Blended Finance Taskforce.

As both our dataset and the OECD mobilisation survey are available in disaggregated format,⁶⁸ we can go one step further and tentatively look at leverage ratios within specific sectors and in different country income categories, as shown in Figures 3 and 4.

A striking observation is the low financial leverage ratio of LICs (Figure 3), which should not be surprising, as it is more difficult

Figure 3 Leverage ratios by category and sector, nine selected MDBs and DFIs, 2013–2015



Source: Authors’ calculations based on ODI dataset and OECD mobilisation survey.

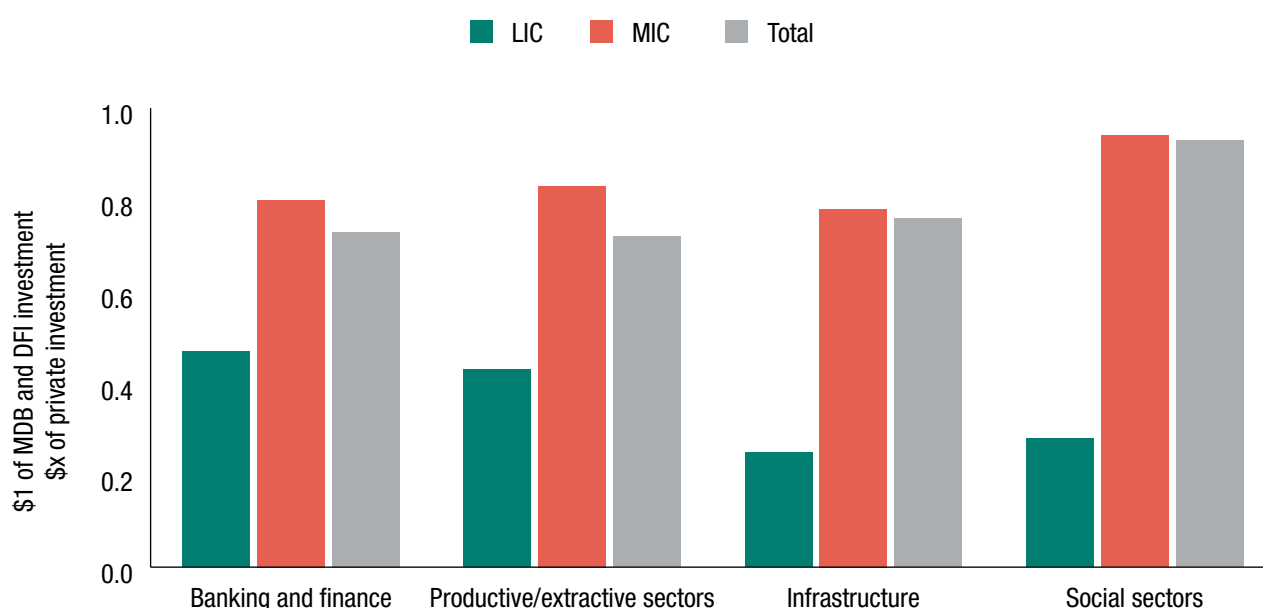
66 Our commitment data are obtained from data reported publicly in the MDB and DFI project-level datasets.

We have assumed they underpin MDB and DFI estimates and OECD reported estimates of private finance mobilised by these institutions.

67 We used our dataset to calculate the total commitment of our nine selected institutions and then calculated a simple annual average per institution. We then used the OECD dataset to calculate the total mobilisation for our nine selected institutions and then calculated a simple annual average mobilisation per institution. We combined the two to estimate the overall leverage ratio. We then divided the data in both datasets by income classification, by instrument and by sector for more disaggregated leverage ratios.

68 We use 2016 OECD mobilisation data (Benn et al., 2017), as they are available at a more disaggregated level. No MDB and DFI mobilisation data are available. The calculated leverage ratios would probably be higher if that data were available, as the aggregate mobilisation figures reported by MDBs and DFIs are vastly different to the numbers reported by the OECD (Figure 2).

Figure 4 Sector leverage ratios by country income group, nine selected MDBs and DFIs, 2013–2015



Source: Authors' calculations based on ODI dataset and OECD mobilisation survey.

to mobilise private finance in these markets than in more stable ones, due to higher levels of perceived or actual risk, less conducive investment climates, etc. We estimate a leverage ratio of 1:0.37 in LICs, that is, \$1 of public investment mobilises \$0.37 of private finance. The ratio triples to 1:1.06 in LMICs, but falls to 1:0.65 in UMICs. This would suggest that blended finance is perhaps more suited to LMICs. The other interesting finding is that leverage ratios appear to be low and fairly consistent across sectors, with a (surprisingly) slightly higher ratio in the social sector.⁶⁹

When we look at differences between country income categories and sectors (Figure 4), we see that sector leverage is higher in MICs and at least double that of LICs across the board. Leverage ratios are lowest in infrastructure in both LICs and MICs.⁷⁰ Leverage is very low in infrastructure and the social sectors in LICs. This may reflect their lack of bankable projects

and the lack of secure streams of positive cash flow to repay investors in the social sectors, or the limited opportunity to invest at scale in a way that is efficient for structuring blended-finance transactions. This reinforces the need to think carefully about the allocation of ODA to ensure it is properly targeted at eliminating extreme poverty.

5.2.3 Policy issues raised by low leverage ratios

As mentioned, data limitations hinder the ability to estimate leverage ratios with any degree of precision. Nevertheless, there is a clear emerging picture and, with it, several policy issues.

First, policy-makers need to rein in their expectations of the potential of blended finance. ‘Billions’ would appear to be a more realistic goal than ‘trillions’. Our estimates suggest that leverage ratios are low, which could allay concerns about the issue of financial

⁶⁹ Future ODI research will explore blended finance and leverage in the social sectors, as equity issues are likely to be raised, alongside the question of whether this is just a different way of financing public expenditure on social services (in other words, buying private provision).

⁷⁰ We attempted to look at leverage ratios by instrument and country income classification, but this was not possible to do for several reasons. For example, the DAC category of direct investment in companies includes both equity and debt investment and several MDBs and DFIs do not report equity investment.

additionality. However, these low levels suggest there is a real need to temper the expectations of policy-makers in relation to the potential of blended finance to shift the financing needle from ‘billions to trillions’ of investment for development, especially in LICs. It is unrealistic to think that blended finance can mobilise the trillions of dollars of private finance needed to meet the SDGs in MICs and LICs. In the best-case scenario, investment in blended finance would mobilise at most \$220 billion a year, assuming an extreme 100% ODA reallocation into blended finance. And, for the purposes of illustration, even if 100% of ODA were invested in mobilising private finance in LICs, it would only generate a maximum of \$54 billion a year.

Second, there is an urgent need to understand the development additionality and value for money of blended-finance investment. Low leverage ratios also raise a different set of potential issues surrounding development additionality and value for money. Low leverage ratios imply a large role for ODF in investment. For example, our system-average leverage ratio of 1:0.75 implies that the public sector (the MDBs and DFIs) has picked up approximately 57% of the cost of the investment. As blended finance does not often mitigate risk, but transfers

it from the private to the public investor, it is critical to understand the development additionality and value for money of this approach. For example, there may well be other public policy interventions that could support the achievement of the same stated development policy objective, which are more effective and transparent than providing a direct subsidy to the private sector.

Third, institutions need to get better at mobilising private finance. If blended finance is to be scaled up rapidly, these leverage ratios need to increase significantly. Fundamental system changes will be required to overhaul the development finance system (both public and private). A recent Blended Finance Taskforce (2018a) report attempts to flesh out what this means practically and offers concrete practical recommendations to overhaul the system. In section 7, we argue that blended finance will need to be better tailored to the needs of LICs if the approach is to deliver and highlight the risk that the blended-finance agenda in LICs may become more expensive amid a poor enabling environment and limited supply of commercial or close-to-commercial investment opportunities. This reinforces the pressing need to increase the supply of investment opportunities.

6 The current state of blended finance in LICs

Key findings

- The share of private finance mobilised by blended finance flowing to LICs is very small.
- The flow of private finance mobilised through blended finance reflects a broader trend in the flow of other external private capital flows to LICs and is commensurate with their relative size in the global economy.
- MIGA, France and the US are the largest mobilisers of private finance in LICs. Bilateral DFIs appear to play a more important role in LICs than MDBs and RDBs.
- The share of total private finance mobilised in LICs has fallen over time, as several large LICs have transitioned to LMIC status. What's more, flows are concentrated in the relatively richer LICs.
- Infrastructure is the largest sectoral recipient of blended finance in LICs, at almost 50% of total commitments. More blended finance goes to infrastructure in LICs than in other country income groups. Very little goes to the social sectors of LICs.
- Loans are the most prevalent instrument for mobilising private finance in LICs, accounting for 56% of total commitments. These are followed by guarantees, accounting for 22% of total commitments in LICs. Lines of credit are hardly used at all in LICs, in stark contrast to UMICs.
- We see limited use of equity in LICs or MICs, and little variation in the tailoring of instruments in LICs.
- Project size is much smaller in LICs than in MICs. The average project size in LICs in 2016 was \$14 million, compared with \$32 million and \$74 million, respectively, in LMICs and UMICs.

In the analysis that follows, we include private finance mobilised by MDBs and DFIs which has been financed 100% by MDB and DFI own-account operations. We also focus on a subset of the total blended-finance universe, as we do not cover all MDBs and DFIs in the OECD

survey and exclude NDBs. Our selected MDBs and DFIs mobilised 77% of total private finance mobilised overall and 85% of total private finance mobilised in LICs between 2012 and 2015, according to the (2016) OECD survey, so we cover the main traditional actors.⁷¹

⁷¹ Note that our focus sample of MDBs and DFIs only includes three DFI members of the EDFI. In total, EDFI members had 31% (€11.5 billion) of their total investment portfolio invested in sub-Saharan Africa at the end of 2017. EDFI members invested about €2.2 billion in sub-Saharan Africa in 2017 (EDFI, 2018).

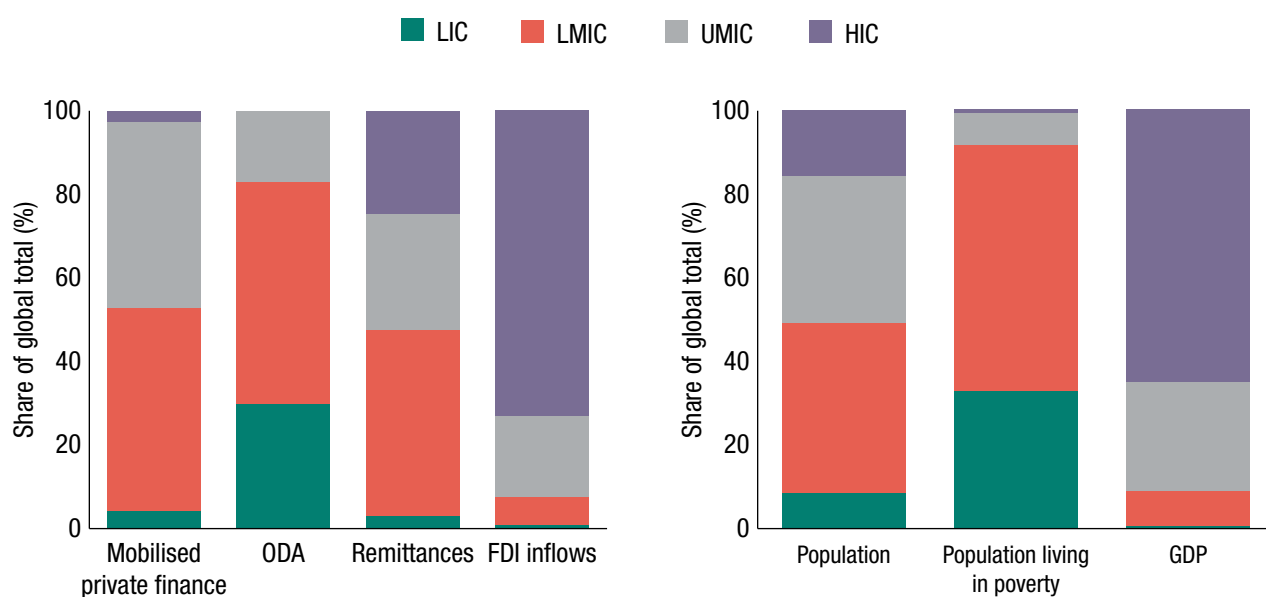
6.1 How much private finance is being mobilised in LICs?

Blended finance is mainly mobilising private finance in MICs, with very little mobilised in LICs. Analysis of OECD data finds that 3.6% (\$2.9 billion) of the total private finance mobilised in 2012 to 2015 flowed to LICs, equivalent to \$725 million per annum, while LMICs and UMICs accounted for around 40% each (Benn et al., 2017).⁷² These findings chime with the findings of the joint MDB surveys on the direct mobilisation of private finance. The first MDB report (World Bank, 2017b) estimated that MDBs directly mobilised \$1 billion in LICs (\$5.9 billion in total). The most recent MDB survey (World Bank, 2018a) estimates that MDBs and the EDFI directly mobilised \$1.6 billion in

LICs in 2017 (\$5.3 billion in total). The DFI Working Group on Blended Concessional Finance reported that MDBs and DFIs mobilised \$145.1 million in private finance in LICs in 2017 using blended concessional finance (DFI Working Group, 2018).

We should not be surprised by the concentration of blended finance in MICs. It reflects a broader trend in the flow of other external private capital flows, such as foreign direct investment (FDI), which flows to countries with more favourable investment climates and is commensurate with the relative size of their economies compared with LICs, as seen in Figure 5. Blended finance is better suited to MICs, as the majority of DFIs have traditionally operated on a commercial basis just below market, with very little DFI investment classified

Figure 5 External financial flows: income-group comparison



Source: Mobilised private finance data (2012–2015) from Benn et al. (2017); ODA (2015) data from OECD CRS; Remittance data (2016) from World Bank (2017c); FDI inflows data (2016) from the United Nations Conference on Trade and Development (UNCTAD) (FDI inward and outward flows and stock, annual, 1970–2016); population data (2016) from the World Bank World Development Indicators (SP.POP.TOTL); poverty data (2013) from World Bank (2017a); gross domestic product (GDP) data from the World Bank World Development Indicators (NY_GDP_MKTP_KD). All data accessed November 2017.

⁷² A substantial share of blended finance is invested on a regional basis, rather than in a specific country. This is particularly the case where investments are made in intermediated investment funds, which on-lend or invest directly in companies. This type of investment cannot easily be categorised by income classification. In the 2016 OECD survey, 9% of the total finance mobilised was classified as regional, 45% of it is through intermediated investment funds. As regional and global funds may also provide financing in LICs, the real share of blended finance is probably slightly higher than the OECD survey suggests.

as ODA (as it did not meet ODA concessionality thresholds). As expected, we also see greater dependence on ODA in the external financing mix in LICs (Figure 5).

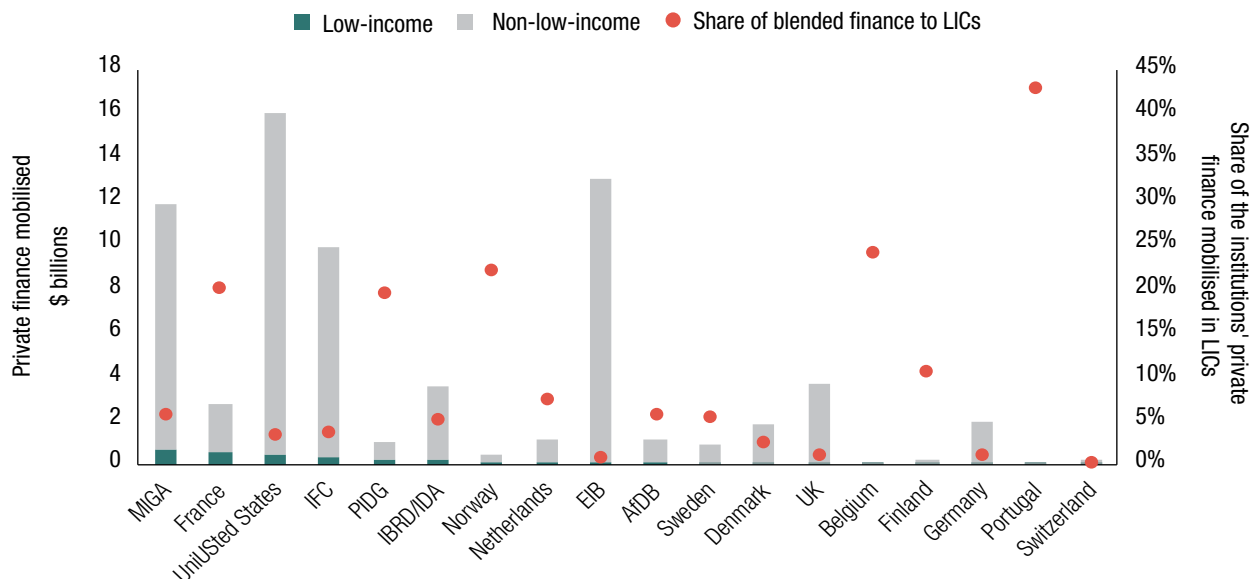
6.2 Who is mobilising private finance in LICs?

Based on OECD data,⁷³ the largest actors mobilising private finance generally are also, to a large extent, the largest actors mobilising private finance in LICs. In most cases, this owes more to the sheer size of their blended-finance operations than a particular focus on LICs. For example, the US is the third-largest mobiliser of finance in LICs, but only 3% of its total blended finance goes to LICs. France, in contrast, is only the ninth-largest blended-finance actor in overall terms, but 20% of its blended finance is mobilised in LICs, making it the second-largest actor in those countries (Figure 6).

Figure 7 compares each actor's share of the total private finance mobilised across all actors and their share of finance mobilised in LICs only. MIGA, France, the Private Infrastructure Development Group (PIDG) and Norway stand out as playing an outsized role in LICs compared with their overall importance in the blended-finance landscape. For example, while France accounts for only 3% of total private finance mobilised, it accounts for 20% of the total finance mobilised in LICs. The opposite is true for the EIB, EBRD, UK, IADB and ADB, which are large blended finance actors. For some, such as the EIB, EBRD, ADB and IADB, this is to be expected, because of their geographical focus. The UK seems to play a smaller role in LICs than its overall level of importance in blended finance would imply.

According to the 2016 OECD survey (Benn et al., 2017), MDBs and RDBs account for around two thirds of all private finance mobilised

Figure 6 Private finance mobilised through blended finance by institution, 2012–2015



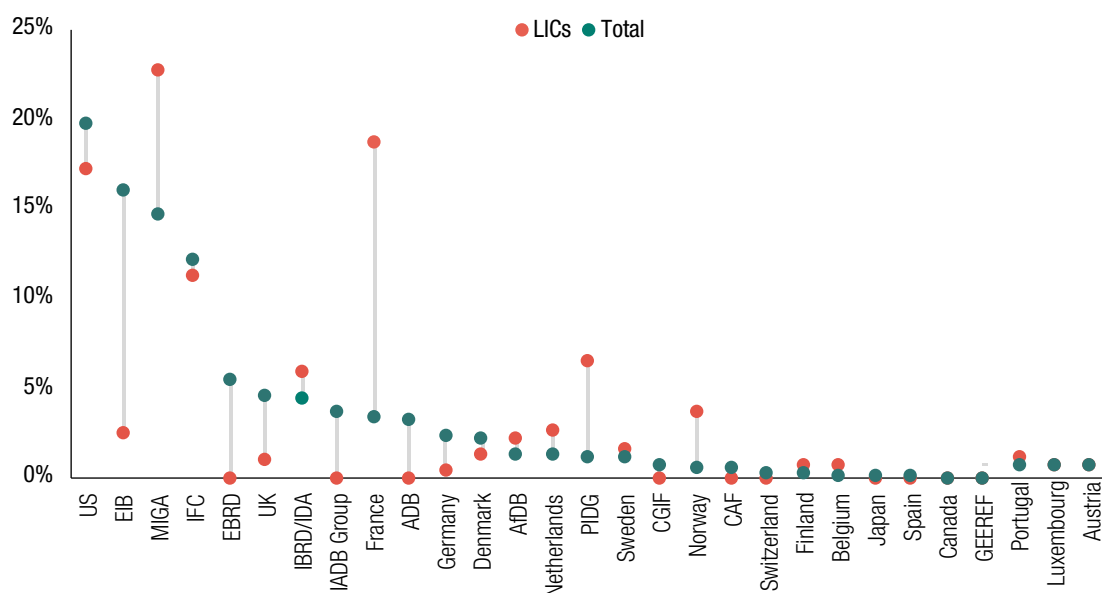
Note: Institutions with no blended finance in LICs are not included in these figures (EBRD, IADB, ADB, the Credit Guarantee and Investment Facility (CGIF), the Development Bank of Latin America (CAF), Japan, Spain, Canada, the Global Energy Efficiency and Renewable Energy Fund (GEEREF), Luxembourg, Austria). US mobilisation is 86% from OPIC and 14% from the United States Agency for International Development (USAID).. French mobilisation is 60% is from AFD and 40% is from Proparco. EIB excludes activities in EU and European Free Trade Area (EFTA) countries. Source: OECD semi-disaggregated dataset (OECD, 2017).

73 The agency-level data in the OECD dataset (OECD, 2017) do not disaggregate by recipient country.

through blended finance. This finance is usually generated by their private-sector arms, with bilateral institutions mobilising the remaining third. Interestingly, when we look at which institutions are mobilising private finance in LICs, bilateral DFIs appear to be playing a more important role, as they account for a combined 50% of private finance mobilised. DFIs are different institutions to MDBs and RDBs; many

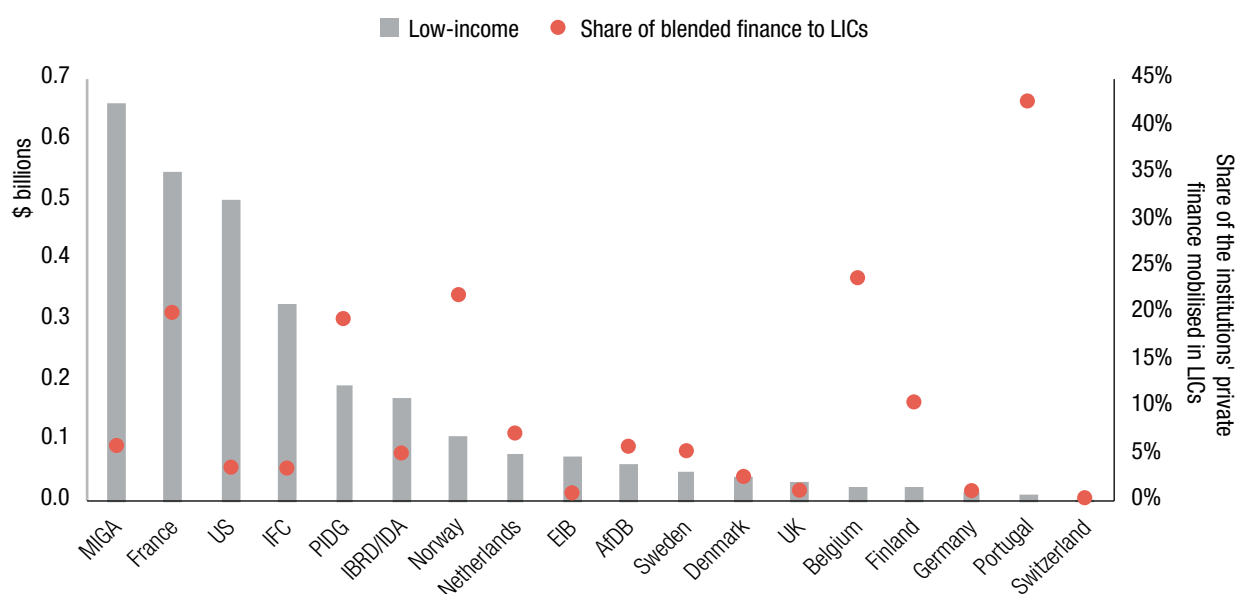
are investment companies and/or funds, which are not regulated in the same way as banks and they are not financed by the capital markets. This means they can have a relatively higher risk appetite than some MDBs and RDBs. France and the US mobilise more private finance in LICs than the IFC. Also, France, the US, Norway and the Netherlands mobilise more blended finance than the ADB, which suggests, given its capital,

Figure 7 Share of total private finance mobilised, overall and in LICs, 2012–2015



Source: Authors' calculations based on the OECD semi-disaggregated dataset (OECD, 2017).

Figure 8 Private finance mobilised in LICs, 2012–2015



Source: Authors' calculations based on the OECD semi-disaggregated dataset (OECD, 2017).

geographical focus⁷⁴ and mandate, that the AfDB should play a larger role than these bilateral actors (Figure 8).

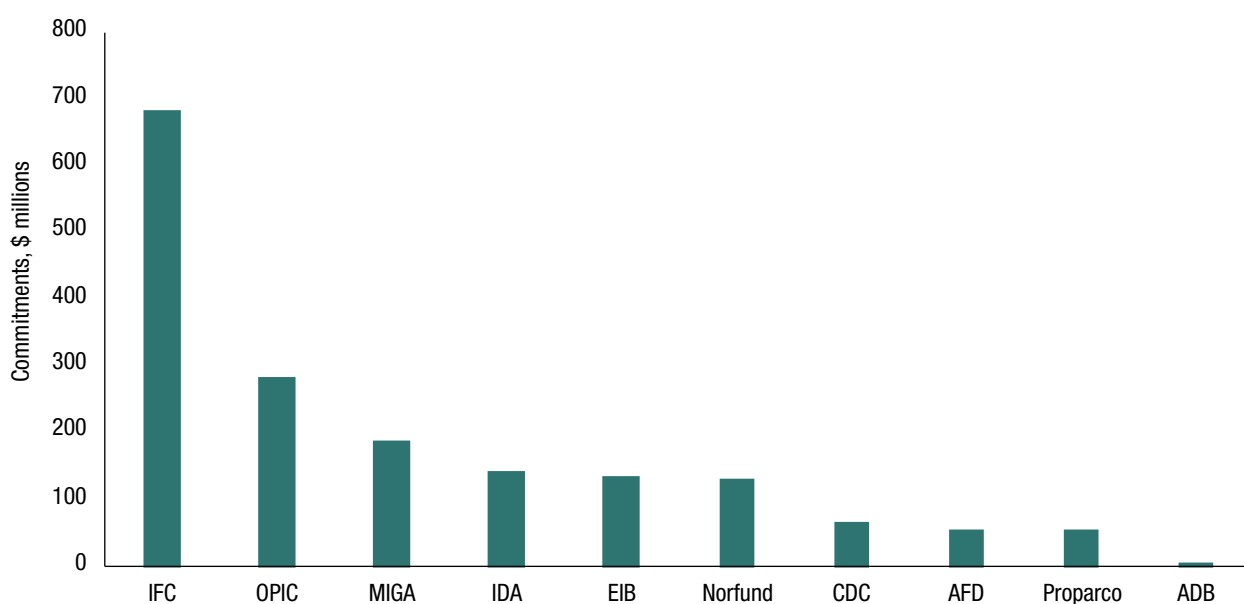
We would also expect the volume of private finance mobilised to increase in the coming years as several new initiatives bed down, most notably the new \$2.5 billion IDA18 IFC-MIGA PSW and the new IFC general capital increase of \$5.5 billion. The PSW will be a key tool supporting the IFC’s new 3.0 strategy, along with its general capital increase and MIGA’s 2018–2020 strategy to scale up efforts in the poorest countries.⁷⁵

Based on this OECD overview of the largest blended-finance actors in LICs, we selected 11 institutions for a more detailed drill-down. Combined, these institutions mobilised 77% of total private finance mobilised overall and 85% of total private finance mobilised in LICs between 2012 and 2015, according to the (2016) OECD survey. Annex 1 contains our institutional

selection process and Annex 2 outlines the methodology we used to identify blended-finance commitments. Data were available for 10 of our 11 selected institutions.⁷⁶ Together, 7.1% of their total own-account commitment to mobilising private finance was directed to LICs between 2013 and 2016 – amounting to an annual average total institutional commitment of \$1.6 billion. A total of 313 blended-finance projects in LICs were identified in the 2013–2016 period. The analysis that follows uses the ODI dataset on institutional commitments to analyse blended finance in LICs in more detail.

Figure 9 shows the average annual commitments by MDBs and DFIs to mobilise private finance in LICs. Compared with the relative mobilisation rankings of the OECD mobilisation survey (Figure 8), the IFC makes the largest annual commitment to mobilise private finance, while OPIC, MIGA and the French agencies (AFD and Proparco) made significantly

Figure 9 Average annual MDB and DFI commitments to mobilise private finance in LICs, 2013–2016



Note: Average for years with available data. For ADB, AFD and Proparco, data are only available for 2016. ADB value is \$5 million. Data were not available for AfDB.

Source: Authors’ calculations based on the ODI dataset.

74 Of the 34 countries classified as LICs as of July 2018, 27 are in sub-Saharan Africa.

75 For example, it is envisaged that by 2030 15% to 20% of the IFC’s commitments will be in LIC-IDA and IDA fragile and conflict-affected countries (IFC, 2018).

76 Data were not available for the AfDB.

lower annual commitments. At first sight, this suggests that several bilateral DFIs may have higher leverage ratios in LICs than the IFC.

6.3 In which LICs does blended finance mobilise private finance?

Between 2013 and 2017, according to our dataset, 73% of institutional commitments to blended finance in LICs went to sub-Saharan Africa, with the share increasing over time as non-sub-Saharan African LICs transitioned to LMIC status and the remaining LICs became increasingly concentrated in Africa. As of July 2018, our data show that 27 of the world's 34 LICs were in sub-Saharan Africa.

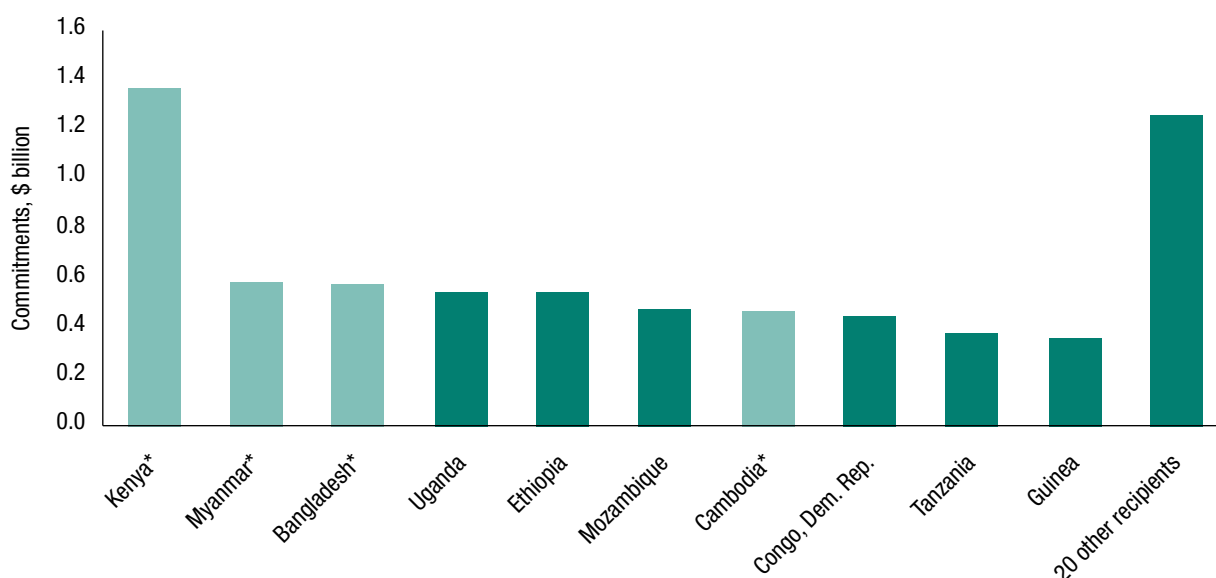
The top 10 LIC blended-finance destination countries accounted for 82% of total blended-finance commitments in 2013 to 2017, according to our calculations. Kenya, before it was reclassified as an LMIC in 2015, was by far the largest recipient of blended finance among LICs (Figure 10). Indeed, several of the main destination countries (Kenya, Myanmar, Bangladesh and Cambodia) were reclassified

during 2013 to 2017, suggesting that they were at the higher end of the LIC income spectrum. Senegal, in contrast, is the only country to have been reclassified *downwards* from LMIC to LIC during the period (in July 2016). If we look at total flows to countries classified as LICs *today*, Senegal would be the largest destination country (\$0.8 billion). However, it does not make the list in Figure 10, because most of the commitments going to it were made when it was still an LMIC.

Because the largest destination countries transitioned to LMIC status, the share of total MDB and DFI commitments to blended finance going to LICs *decreased* from 2013 to 2016. Figure 11 shows the share of total institutional commitments going to countries classified as LICs at the time of the commitment compared with the share of the total commitment to countries classified as LICs at the start of the period.⁷⁷

The concentration of destination countries varies by MDB and DFI, while membership affects the financing destinations of the RDBs. While the IFC has activities in 23 LICs, for example, the ADB only has one (Cambodia). On average, the institutions have activities in

Figure 10 MDB and DFI commitments to mobilise private investment in LICs by destination, 2013–2017

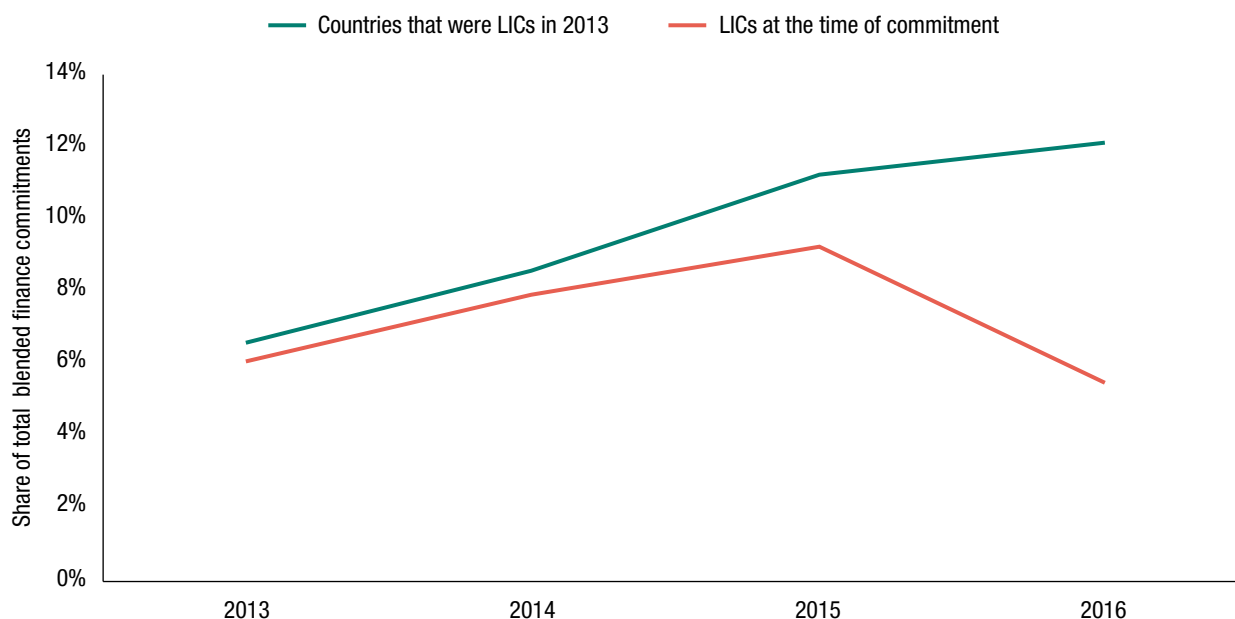


Note: Measures commitments by MDBs and DFIs to countries only for the years they were classified as LICs. *Kenya, Myanmar, Bangladesh and Cambodia were reclassified as LMICs during the period.

Source: Authors' calculations based on the ODI dataset.

⁷⁷ Note that this is not how income classification is handled in the OECD mobilisation survey. See Annex 2 for more information.

Figure 11 MDB and DFI commitments to mobilising private finance in LICs (selected MDBs and DFIs), 2013–2016



Source: Authors' calculations based on the ODI dataset.

Table 3 Largest blended-finance recipient countries by MDB and DFI

AFD	ADB	CDC	EIB	IDA	IFC	MIGA	OPIC	Proparco
Tanzania	Cambodia	Sierra Leone	Kenya	Kenya	Ethiopia	Bangladesh	Kenya	Benin
Uganda		Malawi	Senegal	Uganda	Myanmar	Congo, Dem. Rep.	Myanmar	Burkina Faso
Madagascar		Bangladesh	Malawi	Sierra Leone	Bangladesh	Kenya	Cambodia	Tanzania

Source: ODI Dataset, 2013–2017

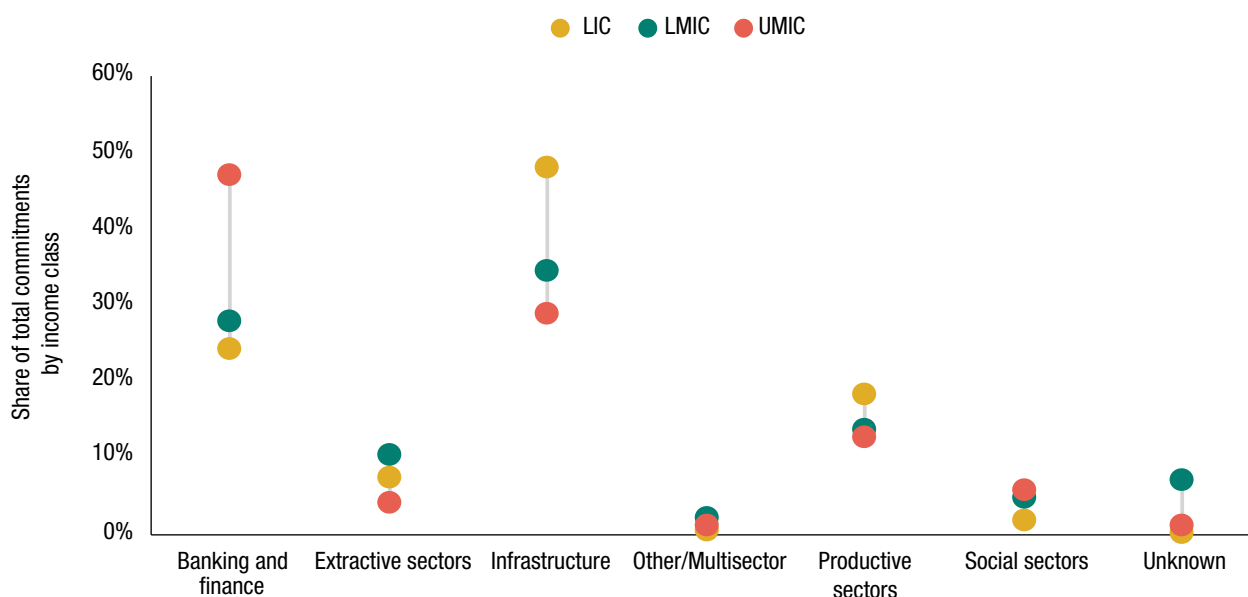
nine LICs, but there is a large degree of overlap. Kenya features as a top three destination country for four institutions, while Bangladesh registers in the top three for three institutions. Table 3 lists the top three blended-finance destinations for each of our selected institutions.

6.4 In which LIC sectors is blended finance mobilising private investment?

The sectoral distribution of MDB and DFI commitments to mobilise private finance in LICs largely reflects the trend at global level, with commitments largely concentrated in infrastructure, banking and finance,⁷⁸ and the productive sectors. The remaining sectors account for a very small share. Very little MDB and DFI blended finance goes to the

⁷⁸ As previously noted, much of the investment that is categorised as flowing to the banking and finance sector is usually lent to local financial institutions, which then lend on to local end-borrowers (mainly SMEs) in a range of sectors, so the sectoral split is not captured.

Figure 12 Commitments to mobilise private finance by sector (selected MDBs and DFIs), 2013–2017



Source: Authors' calculations based on the ODI dataset.

social sectors, possibly due to the economic fundamentals of these sectors, or the fact that there is limited opportunity to invest at scale in the social sectors in a way that is efficient for structuring blended-finance transactions.

There are, however, three noteworthy differences in the sectoral allocation of commitments between country income groups. MDBs and DFIs allocate more capital to mobilise private finance in infrastructure in LICs than in MICs, where the focus is on the banking and finance sector. Interestingly, commitments to mobilise private finance in the social sectors are mainly made in MICs. Only three DFIs made commitments in the social sector in LICs between 2013 and 2017 (CDC Group, 2%; IFC, 1%; OPIC 5%).

Almost half of the blended-finance commitments to mobilise private finance in LICs by our selected MDBs and DFIs are to infrastructure, making it by far the largest sector overall in LICs (Figure 12).

This aggregate picture, however, masks variations among the MDBs and DFIs. While infrastructure is the largest LIC sector for six out of the nine selected MDBs and DFIs with sufficient data, the share of infrastructure ranges from 93% of commitments at the IDA to 32%

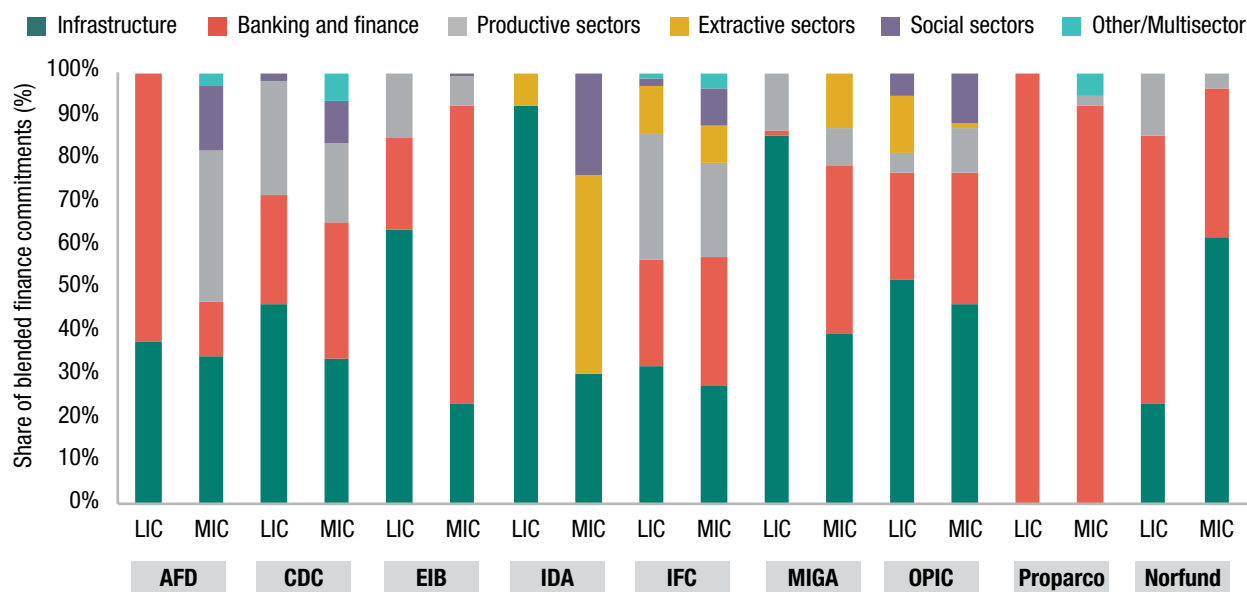
at the IFC (Figure 13). Notably, Norfund and the two French institutions are the outliers in terms of sectoral focus – both Proparco and AFD have had a stronger focus on banking and finance than on infrastructure in LICs.

Individual MDBs and DFIs also show variations in their sectoral commitments to LICs versus MICs. As Figure 13 suggests, infrastructure is larger in LICs than in MICs for all the MDBs and DFIs, although the scale of the difference varies; IDA commitments in LICs are three times more likely to be in infrastructure, while at AFD, the difference is only three percentage points. In the banking and finance sector, the trend is less clear. Most MDBs and DFIs are more likely to make commitments to mobilise finance in this sector in MICs than in LICs, but the opposite holds for AFD and Proparco.

6.5 Which instruments are used to mobilise private finance in LICs?

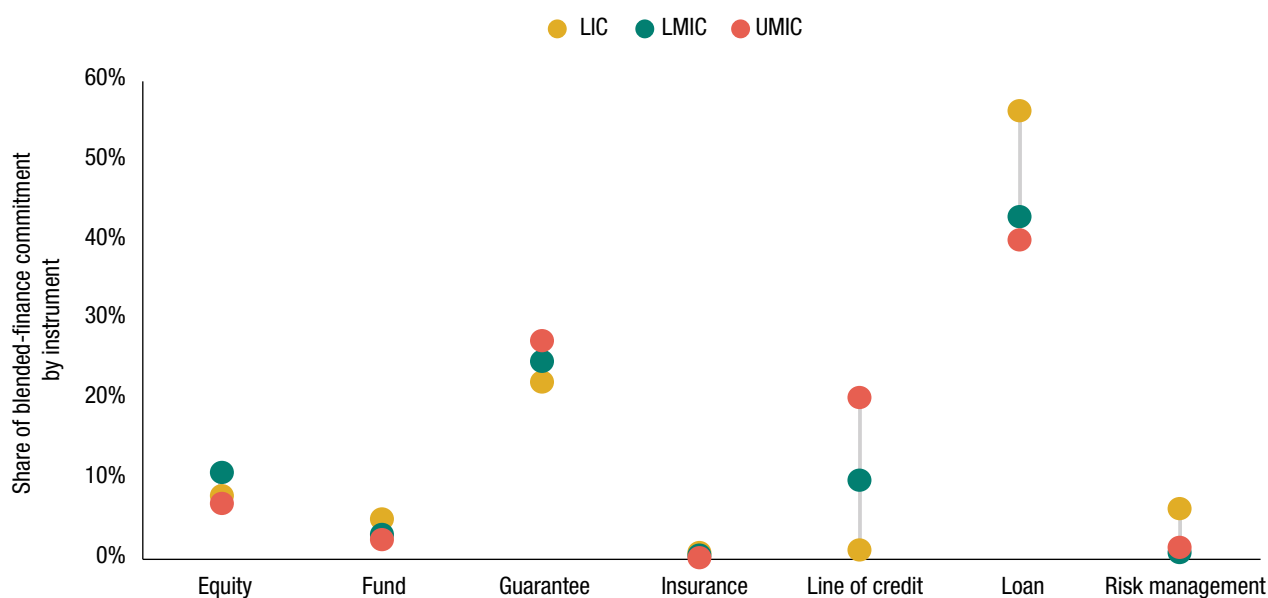
Loans are the most commonly used instrument for mobilising private finance in all country income groups, but they are even more common in LICs. The opposite is true for lines of credit, which are more commonly used in MICs, but hardly used at all in LICs. This is partly due to the composition

Figure 13 Blended-finance commitments by sector and MDB and DFI, 2013–2017



Source: Authors' calculations based on the ODI dataset.
 Note: ADB data not available by sector; AfDB data not available.

Figure 14 Commitments to mobilise private finance by instrument (selected MDBs and DFIs), 2013–2017



Source: Authors' calculations based on the ODI dataset.
 Note: ADB data not available by sector; AfDB data not available

of the institutions studied; lines of credit are only used by the EIB,⁷⁹ for example, and it tends to use them more often in MICs. We also see limited

use of equity in all income categories; aside from the IFC, it seems to be the preserve of the bilateral DFIs. There is very little variation in the

⁷⁹ In our dataset, only the EIB used lines of credit. Although France and Norway reported lines of credit to the OECD 2016 survey (Benn et al., 2017), they were not identified as such in the project descriptions in their public databases. The IFC did not report the use of lines of credit to the OECD survey. The AfDB was excluded, as data were not available, and ADB data were not included, as a breakdown by instrument was not available.

remaining instruments between income groups: guarantees, direct equity, funds, insurance and risk-management tools are all commonly used, regardless of country income category.

Loans are by far the preferred method of mobilising private finance in LICs; 56% of commitments were made using loans (Figure 14) between 2013 and 2017. The remaining MDB and DFI commitments took the form of guarantees (22%), and a very small amount was committed using direct equity, insurance, lines of credit and risk management (each less than 10%). As mentioned in section 6.1, funds are usually (but not always) regional or global, meaning they are not classified as investing in LICs specifically, though in practice, some of their investment probably goes to LICs. This implies that the significance of funds in LICs is being underestimated in our dataset.

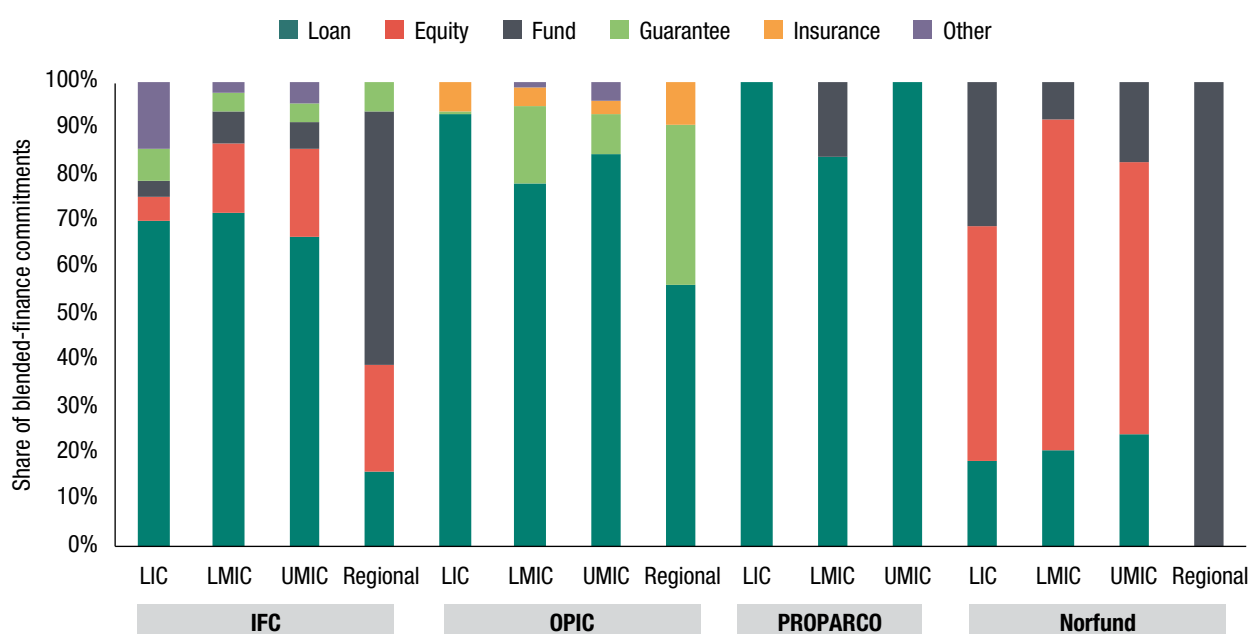
As mentioned, any variation in the use of loans and lines of credit between income groups is largely the result of just a few MDBs and DFIs. For most of the MDBs and DFIs (which we call group A), there is limited variation between country income groups. More than 80% of the commitments to mobilise private finance by OPIC and Proparco are made using loans, and

that holds across all country income groups, while 65%–70% of IFC commitments are in loan form, with almost no variation between country income groups (Figure 15). Norfund stands out as using a large share of equity in all country income groups, albeit slightly less in LICs. MIGA and the IDA only use one instrument – guarantees – in all of their blended-finance operations.

At AFD, CDC Group and the EIB, however, different instruments are used for different income groups – group B (Figure 16). At AFD, guarantees are more *commonly* used in LICs, with loans accounting for a larger share of their portfolios in MICs. Meanwhile, at CDC Group and the EIB, loans are used less commonly in MICs; at CDC, loans give way to direct equity investment in richer income groups, while at the EIB, lines of credit are preferred.

For six of the nine MDBs and DFIs for which data are available, there appears to be limited variation in the instruments used to mobilise private finance across country income groupings (Figure 15). At first glance, this may imply a rather limited ‘toolkit’ and little tailoring of instruments to country circumstances. In some cases, however, this is down to the mandate of

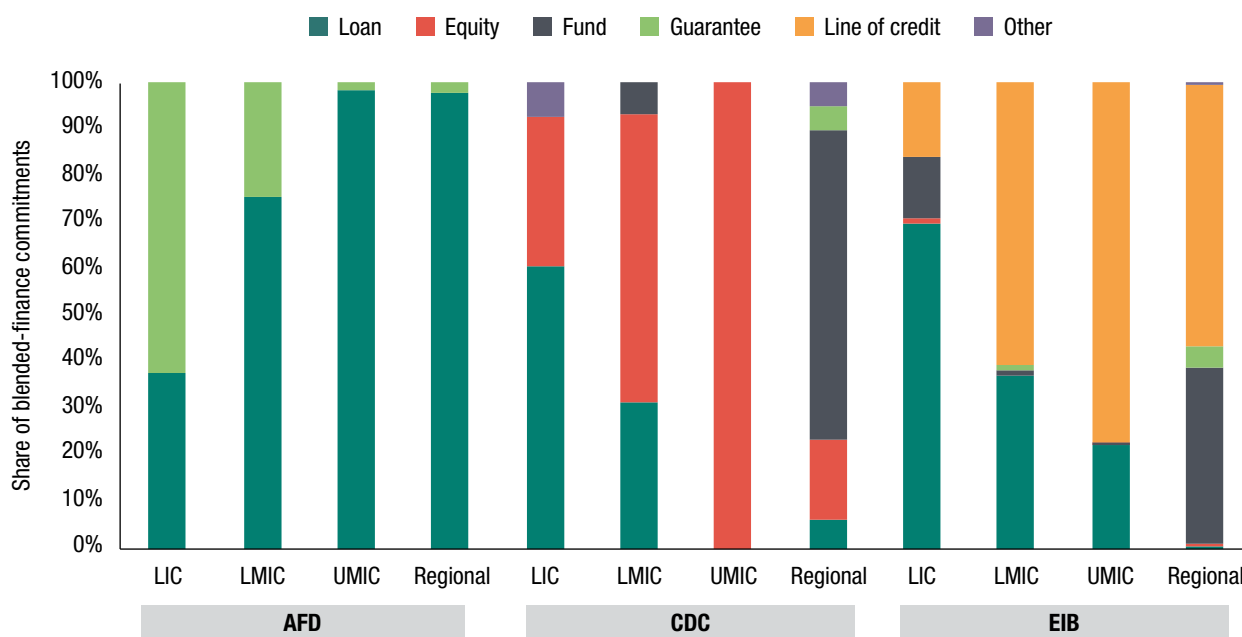
Figure 15 Limited variation in instruments use, by income classification (MDB and DFI group A)



Note: 100% of MIGA- and IDA-only blended-finance operations use guarantees, so there are six institutions with limited variation.

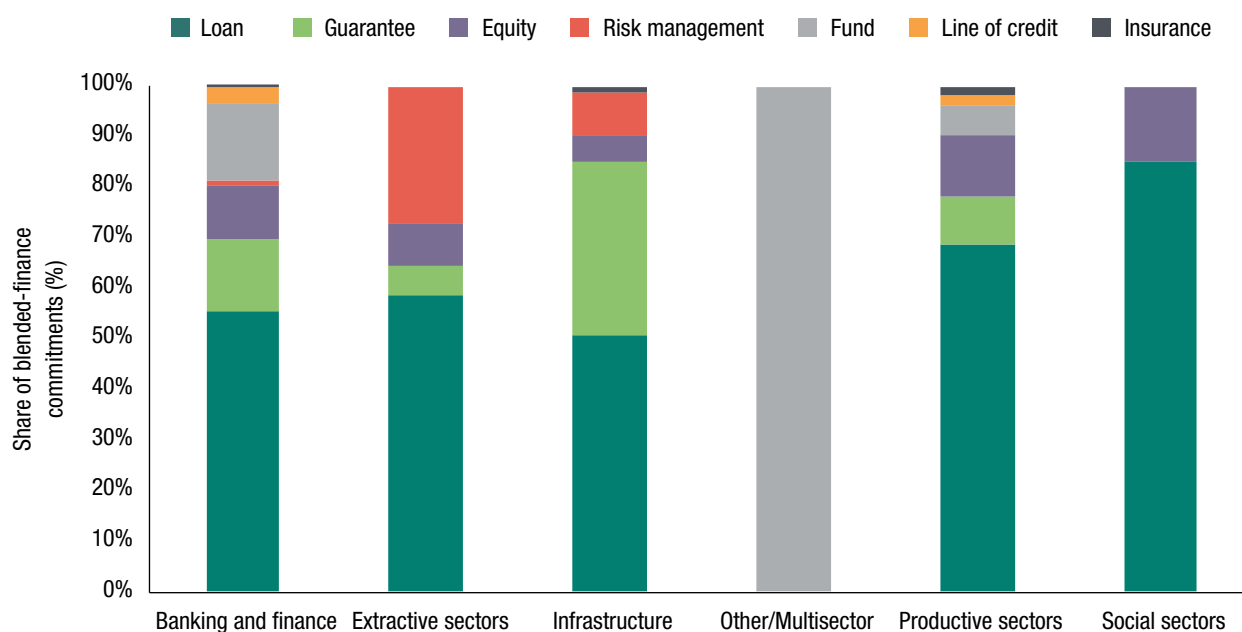
Source: Authors’ calculations based on the ODI dataset.

Figure 16 Variation in instrument use by income classification (MDB and DFI group B)



Source: Authors' calculations based on the ODI dataset

Figure 17 Instruments used for private-sector mobilisation in LICs, by sector



Source: Authors' calculations based on the ODI dataset, 2013–2017.

the institution, as in the case of MIGA, which only issues political risk insurance and credit enhancement. It can also be due to operational restrictions imposed by regulation and/or statute, which may prohibit the use of certain instruments, as in the case of OPIC, which is not authorised to make equity investments.

6.6 Instrument use by sector in LICs

Although the use of loans dominates all sectors, there are minor trends worthy of attention. Infrastructure stands out as the sector with the lowest share of loan commitments and the highest share of commitments via guarantees (Figure 17).

The large share of infrastructural guarantees is, to a large extent, a reflection of the heavy involvement of MIGA and the IDA, both of which only use guarantees to mobilise private finance. They are also large institutions, accounting for almost 20% of total commitments in LICs. At the other end of the spectrum, commitments to the social sectors see the heaviest use of both loans and equity. Investments in funds are often not classified by sector, as the funds themselves are usually multi-sector. Nor do we know the ultimate sector destination of blending classified as going to the banking and finance sector.

6.7 Blended-finance project size in LICs

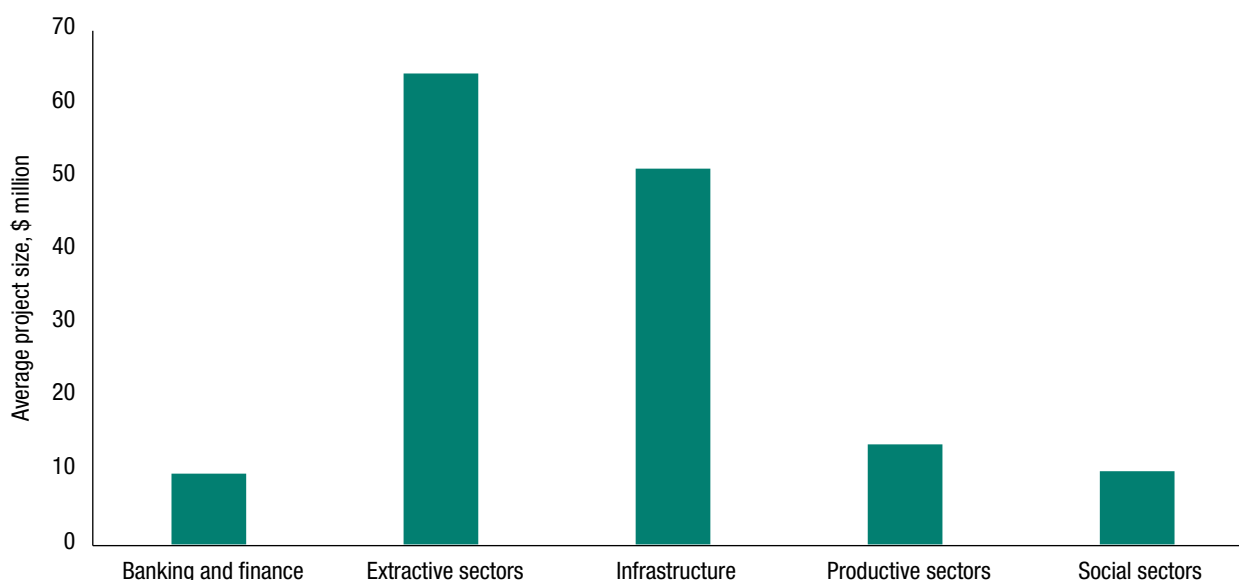
A commonly cited challenge to expanding blended finance in LICs is the high transaction costs associated with small project size. Large-ticket investments are thin on the ground in LICs, which arguably limits investment attractiveness, for example, from an institutional-investor perspective.

Our dataset shows that projects are much smaller in LICs than MICs. While the average

project size in LICs in 2016 was \$14 million, the average size was \$32 million in LMICs and \$74 million in UMICs. However, these averages are inflated by a small number of particularly large projects. The respective median project sizes are just \$1 million, \$4 million and \$37 million. Furthermore, behind the averages, we find large differences between institutions. While project sizes tend to be much smaller in LICs, there are notable differences between average project sizes from institution to institution in LICs. While the AFD average project size in LICs was only \$900,000 in 2016, for example, MIGA projects in LICs average \$95 million.⁸⁰

Breaking down LIC projects further, we also find large variations in project size between sectors and instruments. Projects in the extractive and infrastructure sectors are much larger, on average, than other projects, while projects in banking and finance, and the social and productive sectors are smaller than the average LIC project (Figure 18). Risk-management projects, meanwhile, are by far the largest projects,⁸¹ while equity and fund investments tend to be smaller.

Figure 18 Average project size by sector in LICs



Source: Authors' calculations based on the ODI dataset, 2013–2017.

80 This, however, is based on only two projects.

81 This is based on only seven projects.

7 The need for a more tailored approach for LICs

Key findings

- There is limited use of concessional finance to blend in LICs, compared with UMICs and HICs.
- The potential of blended finance in LICs is constrained by several factors, most notably poor investment climates, a lack of investable opportunities, limited use of subordinate instruments and the limited risk appetites of MDBs and DFIs.
- Private commercial finance will not flow freely to countries, especially LICs where the local investment climate is challenging, where markets are not functioning and where the risk-adjusted rate of return is uncompetitive. Blended finance can tip the balance, but it will not work if the fundamentals are not in place. The emphasis on blending should not eclipse the need for grant financing to strengthen local investment climates.
- There is a scarcity of private investors willing to take on early-stage and pioneer risks in LICs, but also limited use of subordinate instruments by MDBs and DFIs, suggesting that blended finance may not be meeting the risk-mitigation needs of the private sector in challenging markets.
- Conservative MDB and DFI financing models and the returns required on blended concessional finance are constraining risk appetite and the ability to engage in LICs. Donors should revisit the rates of return they require on concessional resources and the ‘hurdle rates’ of bilateral DFIs.
- MDBs should develop a more uniform gauge of capital adequacy that elucidates the scope for risk. They should also incorporate callable share capital into their capital-adequacy models.
- Since 2014, global private investment in infrastructure has been declining and is now virtually negligible in LICs. Blended finance is not currently crowding in private investment in infrastructure in LICs. There is a need for more blended concessional finance for project preparation, early-stage project financing and to develop more innovative risk-sharing instruments.
- MDBs and DFIs need to adopt a tailored approach to blended finance in LICs.
- This will be crucial to ensure that increased investment of ODA in blended finance delivers for LICs.

7.1 A limited use of concessional finance to blend in LICs

As explained in section 4.1 we would, in theory, expect to see concessional finance playing a particularly important role in blending to mobilise private finance in LICs, given the acute

need to help pioneer and create markets and/or overcome the most pervasive market failures. However, data available to date suggest a much more concentrated use of concessional finance for blending in MICs than in LICs. The DFI Working Group on Blended Concessional Finance reports that 21% of the concessional finance used to blend in 2017 (\$243.2 million) was used to

mobilise finance in LICs, compared with 51% (\$592.5 million) in LMICs, 22% (\$252.4 million) in UMICs and 6% (\$70.2 million) in HICs⁸² (DFI Working Group, 2018).

This is not to say that MICs do not have a valid claim on the use of concessional finance for blending; indeed, the official financing mix and the terms thereof evolve along the income spectrum. We would expect to see blended concessional finance feature strongly in LMICs struggling to access finance on reasonable terms and where there is a need to pioneer and create markets. However, we are questioning whether more blended concessional finance should be used in LICs, for example, rather than in UMICs and HICs, where near market-term finance (funded by MDB and DFI own-account resources and not concessional resources) is much more likely to be appropriate and only small amounts of subsidy might be required to bring the risk-adjusted rate of return in line with the market.

As donors seek to scale up their investment of ODA in blended finance, it is necessary to understand what factors are driving this more limited use of concessional blended finance in LICs. Our research identifies three key drivers, which are interacting with each other: a weak enabling environment and a lack of investable opportunities in LICs; the limited use of subordinate instruments by MDBs and DFIs; and the limited risk appetites of MDBs and DFIs. We discuss each of these drivers in turn. To illustrate how blended finance in its current form is not successfully crowding in private investment in LICs, we discuss the collapse in private investment in LIC infrastructure in LICs.

7.2 Poor investment climate and a lack of investable opportunities in LICs

Much has been written on the impediments to private investment in developing countries, especially LICs, but this is not the focus of this report. Put simply, it is far easier to do business in more ‘developed’ developing countries, where the institutional, legal, regulatory and policy frameworks are stronger, the local capital markets are more developed and the risk-adjusted rate of return is more competitive, than in LICs, where the contrary is often true. Private commercial finance will not flow freely to countries, especially LICs, where the local investment climate is challenging, where markets are not functioning and where the risk-adjusted rate of return is uncompetitive. These weak fundamentals adversely affect the ability of blended finance to mobilise private finance in LICs.

The importance of the investment climate and these fundamentals can be seen in the relationship between private finance mobilised and country credit ratings. In total, we calculated 96.3% of the total private finance mobilised between 2012 and 2015 flowed to countries with a credit rating (Figure 19).⁸³ A country’s credit rating appears to be an important factor influencing the destination of private finance mobilised through blended finance. This makes sense, as private commercial finance is unlikely to flow to sub-investment-grade investment opportunities. To illustrate this point, the average credit rating for many African countries and the private sector⁸⁴ is sub-investment grade; private capital, especially that of institutional investors, is unlikely to flow at scale to such high-risk markets. As 27 of the 34 countries classified as LICs as of July 2018 are in sub-Saharan Africa,

82 The DFI working group notes that the concessional finance used to blend in HICs was mostly for infrastructure projects and climate projects.

83 We conducted further tests on correlation, looking at fragility status, Doing Business index score, least developed country (LDC) status and natural-resource dependence. None of these showed any correlation. We also looked at the correlation to financial depth and the Human Assets Index (www.ferdi.fr/en/indicator/human-assets-index), noting slight correlations, but these indicators have a positive correlation with GDP per capita. See Annex 3 for scatter plots on financial depth and the Human Assets Index.

84 Based on the convention that private-sector borrowers are rated one to three notches below the sovereign rating.

this may explain why so little private finance is mobilised in LICs. Only one country in sub-Saharan Africa is investment grade (Botswana, rated A).

This should encourage policy-makers and donors to think more about the sequencing of support in LICs to mobilise private finance, by placing more emphasis on strengthening local investment climates⁸⁵ and adopting a more holistic, coordinated and long-term approach to help build markets rather than ad hoc blended-finance investment. The current emphasis on blending (at investment level) should not eclipse the need for grants to strengthen the investment climates of LICs, to support country-led programmes of policy reform, local capital-market development and capacity-building. That is a long game and there will be no quick wins.

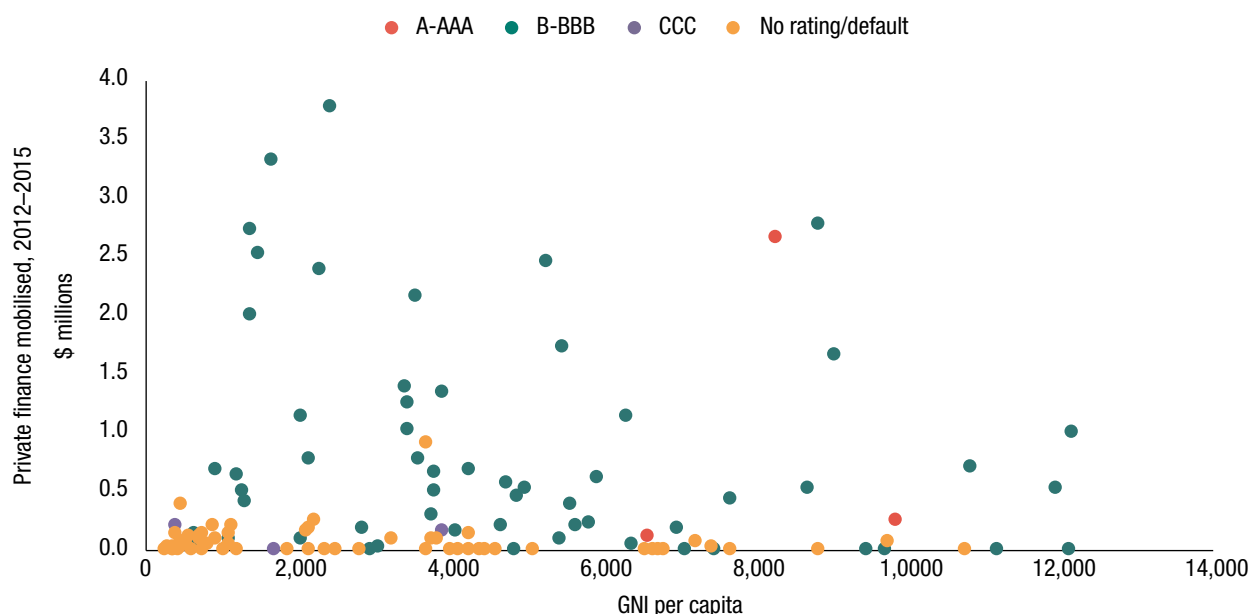
Weak fundamentals adversely affect the risk-adjusted rate of return for investors and, hence, the availability of investable commercial opportunities. As previously noted, we should not be surprised by the fact that blended finance (broadly defined) is mainly mobilising private

finance in MICs. It is more suited to markets where it can bring the risk-adjusted rate of return in line with the market. It can tip the scale where there are investments with close-to-commercial risk-adjusted rates of return, but it will not work in markets where the fundamental economics are not right, and the investment is not financially feasible. We estimate an overall leverage ratio of 1:0.37 in LICs, which implies that that blended finance is actually picking up the bulk (around 73%) of the total cost of investment. This reflects the lack of commercial or close-to-commercial investment opportunities in LICs.

Furthermore, the task of mobilising private finance, especially in LICs, is made even more difficult by the current bleak external financing environment. For example, the OECD reports that, in 2016–2017, FDI in developing countries fell by 30% to \$750 billion and that project finance fell by 30% in the first quarter of 2018 (OECD, 2018h).

In this context, and as MDBs and DFIs are tasked with mobilising more private finance in LICs, there is a risk that MDBs and DFIs will

Figure 19 Mobilised private finance flows to countries with a credit rating



Source: Benn et al., 2017; Standard & Poor's (S&P) Global Ratings, as of October 2017; gross national income (GNI) per capita data (2016 or most recent) from World Bank World Development Indicators (NY.GNP.PCAP.CD).

85 Local investment climates also depend on other forms of public investment, such as health and education, which affect the availability of human capital.

chase fewer and fewer projects and invest in more marginal investment opportunities with higher costs to the public purse (in other words, a higher subsidy to attract private investors). As overall risk is not mitigated in many blended-finance structures, but rather transferred from the private to the public sector, there will be a point at which the provision of such large subsidies to the private sector does not represent value for money.

7.3 Limited tailoring of the blended-finance toolkit in LICs

The rationale underpinning blended finance suggests that the level of subsidy funded by ODF will rise, the higher the level of market failure, and that this subsidy will fall over time as markets develop. This suggests that a significant role will be played by blended finance, especially blended concessional 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.

Given the scarcity of private investors willing to take on these risks, we would expect to see MDBs and DFIs using blended concessional finance to take on these early-stage or pioneer risks using instruments such as subordinated debt, equity, risk-sharing facilities, guarantees and grants. Data from the most recent DFI Working Group on Blended Concessional Finance, however, shows these instruments playing a lesser role and a focus on the use of senior debt⁸⁶ (44% of concessional commitments by volume and 48% of concessional project count) in 2017 (DFI Working Group, 2018). MDBs and DFIs hardly use grants at all. Data show that grants accounted for only 1% of concessional commitment by volume and 1% of concessional project count in 2017 (ibid.).

Our analysis (section 6.5) also finds that debt finance is the most common instrument used to mobilise private finance and that its use is more prevalent in LICs. The use of other instruments shows very little variation between country income groups – guarantees, direct equity, funds,

insurance and risk-management tools are used just as commonly, regardless of the income status of the destination country. For six of the nine institutions with data available, the use of instruments was fairly consistent across country income groups.

At first glance, and in the absence of more detailed data to understand the capital structure of the investments financed, these findings may suggest that the blended-finance approach employed is not specifically tailored to meeting the risk-mitigation needs of private-sector investors in LICs. This may limit the potential of blended finance to mobilise private finance in LICs. This issue suggests that further exploration and discussion is warranted about whether there should be greater use of subordinate instruments and grants to mobilise private finance in LICs and, considering the small ticket size of projects in LICs, whether blended-finance solutions can be better constructed for smaller investments.

7.4 Limited blended private investment in infrastructure in LICs

In the international discourse, blended finance has been assigned a particularly critical role in mobilising private commercial investment to finance the infrastructure gap in developing countries, estimated at \$1.5 trillion per annum by the G20. However, recent ODI research concludes that while there have been successful innovative initiatives by MDBs and DFIs to mobilise private infrastructure investment including the use of blended finance, this has fallen sharply from an annual average of \$37 billion between 2008 to 2014 to just \$13 billion between 2015 and 2017 and is not mobilising at anything like the scale required (Tyson, 2018).

The research finds that although LICs have the greatest need for infrastructure investment, only 2% of total private infrastructure investment went to LICs between 2008 and 2017. Although in line with their relative share of global GDP, this is low. The research also highlights the collapse in private investment in infrastructure

86 In the absence of more data, senior debt investment suggests that MDBs and DFIs are likely to be investing *pari passu* (i.e. same ranking as private lenders in the capital structure with equal rights of payment).

in LICs from just under \$3 billion in 2012 to \$300 million in 2016, which blended-finance efforts have not been able to arrest. Illustrative of the constraints on mobilising private infrastructure investment in LICs is the case of the risk-mitigation facility of the IDA18 PSW. A \$1 billion allocation was made to the risk-mitigation facility under the IDA18 PSW, designed to mobilise private investment in infrastructure in the poorest and most fragile of countries, yet no commitments were made during the first 15 months of the PSW's operation. The mid-term review of the IDA PSW forecasts that the full \$1 billion allocation is unlikely to be fully committed by the end of the IDA18 period (World Bank, 2018c).

This raises questions about whether blended finance, in its current form, can crowd in private infrastructure investment and at the scale required. The recent DFI report on blended concessional finance shows senior debt being predominantly used to mobilise private infrastructure investment, which accounts for 72% of blended concessional investment by MDBs and DFIs. This, in turn, suggests that the MDBs and DFIs are investing *pari passu* with the private sector. Again, we see very limited use of subordinate instruments such as subordinate debt (12%), equity (9%) and risk-sharing (7%), to mobilise private infrastructure investment (DFI Working Group, 2018). Considering the constraints on the mobilisation of private finance for infrastructure investment, there is a clear need to use more blended concessional finance to finance project preparation, early-stage project financing and to develop more innovative risk-sharing instruments to help mitigate political and macroeconomic risk where there is a valid case for subsidising private investment in infrastructure.

Even with more innovative use of blended concessional finance at the earliest stages to develop a pipeline of bankable projects, policy-makers will still need to recalibrate their

expectations of the potential of blended finance to fund infrastructure investment, especially in LICs. It is unrealistic to expect institutional investors to risk trillions in markets where the average credit rating is sub-investment grade. As recent ODI research concludes, at best MDBs and DFIs can

nudge markets in the right direction, while the true step-change in investment patterns will only happen as a result of deeper forces over which MDBs have limited influence. 'Billions to trillions' is a catchy phrase, but when it comes to the ability of MDBs to directly crowd institutional investors into [emerging and developing country] infrastructure, 'billions to tens of billions' is more realistic. (Humphrey, 2018a: 7)

As many infrastructure projects in LICs lack secure streams of positive cash flow, there will still be a critical role for standalone international and domestic public investment in infrastructure for many years to come (*ibid.*).

7.5 The limited headroom and risk appetites of MDBs, DFIs and donors

The ability of MDBs and DFIs to engage in and mobilise more private finance in LICs will depend, in part, on their risk appetite, which is constrained by the need to maintain a AAA credit rating for the MDBs and for DFIs the need to remain profitable and financially sustainable.⁸⁷

As MDBs and DFIs are increasingly tasked with investing more of their own-account resources in riskier sectors and countries, they will need to be empowered to take on more risk. The answer so far has been for donors and third parties to provide concessional capital, which the MDBs and DFIs use to blend with their own-account resources (blended concessional finance), enabling them to shift a part of the

87 The major MDBs' financing model is a powerful one. Small amounts of paid-in donor share capital can leverage large sums of private capital from the international capital markets for investment in the SDGs, but it is dependent on the AAA rating of their bonds.

risk off balance sheet and invest beyond their traditional risk appetites.⁸⁸ To date, however, this approach does not seem to have resulted in a material shift in the overall risk appetite of the MDB and DFI system, as implied by the limited use of this blended concessional finance and the relatively limited use of subordinate instruments to mobilise private finance in LICs.

Although it is early days,⁸⁹ and notwithstanding the impact of the lack of investable opportunities in LICs, more could be done by donors and shareholders to enable MDBs and DFIs to increase their risk appetite. For example, many of the concessional funds and facilities provided by donors that MDBs and some DFIs use to blend require a positive rate of return, or is returnable capital, which restricts the level of risk this capital can carry. Donors could start by reviewing the rates of return they require on these facilities to see whether they could provide more funding in pure grant form.

At the bilateral DFI level, there may be more room for manoeuvre among those not 'slave' to the markets, as shareholders could reassess DFI profitability targets. The UK's DFID, for example, has lowered CDC Group's required rate of return from 3.5% to remaining profitable at the institutional level. Other bilateral shareholders could follow its lead. There are other ideas on the table, too, such as the creation of special-purpose vehicles (SPVs) that focus on providing high-risk capital (such as early-stage finance and high-risk project tranches) (Lee, 2018) and the IADB's proposal to explore the creation of dedicated off-balance-sheet facilities to help overcome institutional capital-adequacy constraints hindering risk appetite and the ability to expand the use of risk-mitigation instruments (Pereira dos Santos and Kearney, 2018).

Interestingly, we find that in contrast to the overall landscape, bilateral DFIs and actors

appear to play a more important role in mobilising private finance in LICs than MDBs and RDBs (section 6.2). For example, France and the US mobilise more private finance in LICs than the IFC. France, the US, Norway and the Netherlands mobilise more private finance than the AfDB, which, given its mandate and geographical focus, would suggest that the AfDB should play a larger role.

At the multilateral level, it is not immediately obvious how conservative the MDB financial models are in terms of capital adequacy. Some argue that that financial models of several MDBs and RDBs are overly conservative and that there is room to expand risk appetite and investment in LICs. All of our selected MDBs and RDBs have very strong capital-adequacy positions, defined by S&P as risk-adjusted capital ratios of more than 15%, up to 23% (Figure 20).

MDBs' and RDBs' scope to take on more risk without affecting their AAA rating is a matter of debate, complicated by the different and frequently changing rating methodologies of the three main credit-rating agencies (S&P, Fitch and Moody's), some of which are not transparent in their assessment or are overly conservative. This makes it hard for MDBs and their shareholders to understand their headroom according to credit-rating methodologies compared with their own models of capital adequacy, which naturally limits their operational capacity.

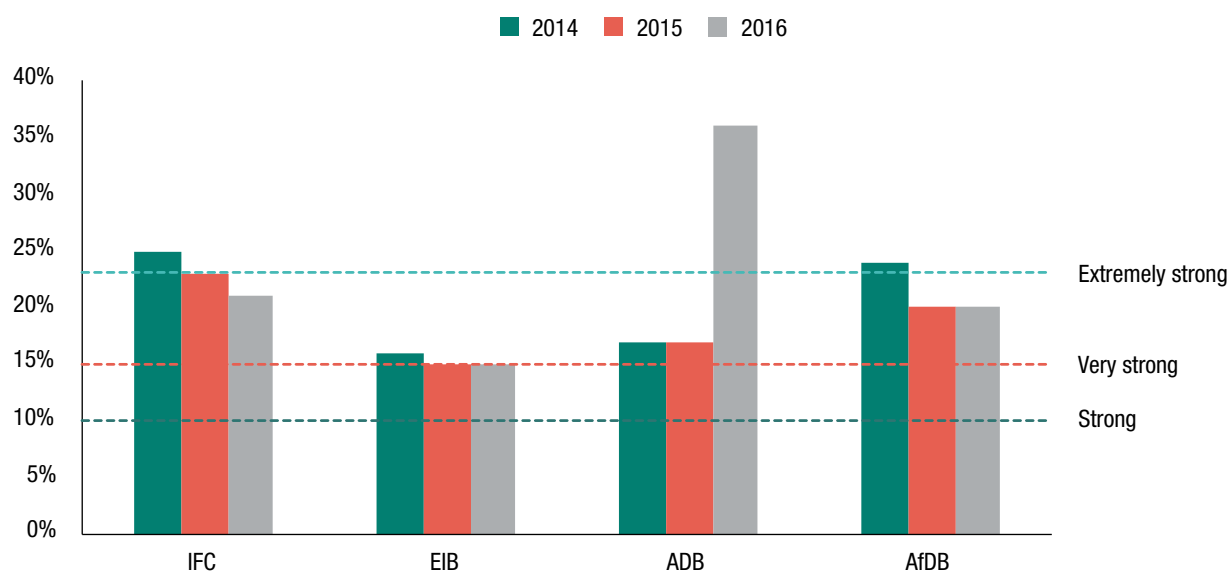
Even so, some argue that if MDBs and RDBs (other than the IFC)⁹⁰ included a portion of callable capital in their own internal capital-adequacy models, lending capacity could be substantially increased (Humphrey, 2018b). Relevant for LICs (as the majority are in sub-Saharan Africa), Humphrey sees potential for the AfDB to increase lending by \$14.1 billion (almost double its lending portfolio). These illustrative calculations imply that there is room

88 In our review of 11 institutions, we noted that this approach was used more commonly by MDBs, multilateral DFIs and RDBs. It was a less common approach for the bilateral DFIs to blend external concessional finance with their own-account resource.

89 A number of large blended concessional initiatives (e.g. the IDA PSW) and several of the more ambitious MDB and DFI strategies, which place more emphasis on investment in LICs, are new (e.g. the new IFC 3.0 strategy and the new CDC 2017–2021 strategy), so it will take time for the results to filter through.

90 The IFC has no callable capital, so S&P issues a standalone credit profile.

Figure 20 MDB and RDB risk-adjusted capital-adequacy ratios, 2014–2016



Source: S&P Global Ratings (2017).

Note: ADB increase is due to the merger of the Asian Development Fund into ADB ordinary capital resources on 1 January 2017.

for MDBs and RDBs to increase their risk appetite without affecting their AAA rating.⁹¹ There is much debate about MDBs’ lack of a uniform approach to assessing their capital adequacy, the approach of the ratings agencies and their impact on MDB operations. This is

not an easy problem to solve, but, borrowing from Humphrey (2018b), two important starting options include the development of a more uniform approach to assessing capital adequacy and the incorporation of a portion of callable capital into capital-adequacy calculations.

91 These illustrative calculations assume that the risk profile of the portfolio remains the same, but increased concentration in LICs would reduce this potential headroom. By how much would need to be explored with further research. Given the size of the headroom in relation to their portfolios, however, it is reasonable to assume that there is room to increase risk appetite.

8 Conclusions and recommendations

The operational reality and blended-finance experience to date suggest that there is an urgent need to recalibrate the policy debate and temper policy-makers' expectations about the potential of blended finance to plug the SDG financing gap in developing countries. There is a significant disconnect between policy rhetoric ('billions to trillions') and the operational reality of blended finance ('billions to billions'). This will help inform policy decisions on the allocation of ODA.

While blended finance presents a global opportunity to maximise the catalytic effect of ODA and mobilise significant sums of additional private commercial finance, we would argue that it also comes with attendant risks, which may have unintended consequences for providers of ODA. First, the big push to invest more ODA in blended finance may result in the further concentration of MIC investments in MDB and DFI portfolios. Second, there is a risk that mobilisation targets will shift the emphasis away from prioritising development impact and ensuring financial additionality. Third, it may well become more expensive to mobilise more private finance in LICs, as MDBs and DFIs chase fewer 'investable' projects and invest in more marginal investment opportunities.

MDBs and DFIs will need to collectively adopt a clearer, tailored approach to blended finance in LICs. This will be crucial to ensure that increased investment of ODA in blended finance, especially blended concessional finance, delivers for LICs.

This report finds that:

1. On average, \$1 of MDB and DFI investment mobilises \$0.75 of private finance. This falls to \$0.37 in LICs. Unrealistic expectations of blended finance's potential to plug the

SDG financing gap need to be recalibrated: a 'billions to billions' framing is a more realistic operational reality.

2. Better understanding of the poverty and development impacts of blended finance and its true costs is required to assess value for money and ensure effective policy-making and allocation of ODA.
3. The potential of blended finance in LICs is constrained by several factors, most notably the countries' poor investment climate, lack of investable opportunities, lack of tailored approach and limited risk appetites of the MDBs and DFIs.
4. The big push to invest more ODA in blended finance risks diverting ODA away from its core agenda of helping eradicate poverty in the poorest countries.
5. Effective policy-making is hindered by the lack of a common official blended-finance framework and very poor data availability, which hampers transparency and accountability and undermines public trust in this approach.

This report offers a suite of recommendations with a view to lowering expectations for blended finance to more appropriate levels and improving its use:

1. **If blended finance is to be scaled up, MDBs and DFIs will need to get better at using blended finance to mobilise private finance, while managing the higher level of risk this implies.** If blended finance is to be scaled up rapidly, overall leverage ratios will need to increase significantly. Fundamental systemic changes will be required, which will mean

taking on far riskier projects. Such changes might include:

- a. making more use of concessional finance and subordinate instruments to meet the risk-mitigation needs of the private sector in LICs
 - b. the use of more concessional finance to fund project preparation, early-stage project finance and to develop more innovative risk-sharing instruments
 - c. revisiting required rates of return on concessional resources used in blending and the ‘hurdle rates’ of bilateral DFIs, in other words, accepting higher levels of financial risk
 - d. MDBs developing a more uniform approach to assessing capital adequacy, which would allow a more transparent understanding of the scope to take on more risk and incorporate callable share capital into their capital-adequacy models.
2. **Donors need to think carefully about the allocation of ODA and the risks and trade-offs of investing ODA through blended finance.** There may well be other public policy interventions that could support the achievement of the same stated development objective, which are more effective and

transparent than providing a direct subsidy to the private sector. For example, MDBs, DFIs and donors could make greater use of grant finance to fund efforts to strengthen local investment climates, focused on supporting country-led programmes of policy reform, local financial-sector development and capacity-building in LICs. As blended concessional finance has not targeted well the poorest countries, and is not used equally in all sectors, donors need to manage the risk that increased investment of ODA in blended finance could divert ODA from the countries and sectors that need it most.

3. **There is an urgent need for better data and transparency.** Efforts should be made to align and harmonise the OECD and MDB blended-finance frameworks. All institutions should publish disaggregated project-level data. The OECD DAC urgently needs to resolve outstanding issues on the treatment of private-sector instruments in the modernisation of ODA, and efforts should be made to publish the ‘grant equivalent’ of blended-finance transactions to the OECD CRS. This should be disclosed publicly at some semi-aggregated level to overcome the commercial confidentiality concerns of MDBs, DFIs and donors.

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Annex 1 Institutional selection process

In selecting institutions for analysis, our aim was to include the largest actors in blended finance overall, as well as the most important actors in a LIC context. We also wanted to compare differences between (a) MDBs, (b) RDBs and (c) bilateral actors. The selection process was as follows:^{92,93}

1. The three largest institutions in the blended-finance world in each category

The top nine institutions fit perfectly into the three groups:

- a. MDBs: MIGA, IFC and IBRD/IDA
- b. RDBs: EIB, EBRD and IADB
- c. Bilateral: US, UK, France

However, at the time of selection in November 2017, the EBRD had no recipient countries classified as LICs, while IADB only had one (Haiti). These banks will naturally have very small or non-existent flows to LICs, which makes them less relevant for our study. We thus replaced them with the next largest institutions, the ADB (with two LICs) and the AfDB (with 27 LICs).

Table A1 Largest blended-finance actors

Actor	Total blended finance (\$) (2012–2015)	Category
US	15,984,962	Bilateral
EIB	13,007,690	RDB
MIGA	11,850,566	MDB
IFC	9,891,875	MDB
EBRD	4,487,264	RDB
UK	3,672,242	Bilateral
IBRD/IDA	3,546,052	MDB
IADB Group	2,943,397	RDB
France	2,766,117	Bilateral

Source: see footnote 92.

92 All data analysis for the selection process is based on the 2016 OECD mobilisation survey (Benn et al., 2017), as it has the most comprehensive available disaggregated data on blended finance.

93 While the public version of the OECD mobilisation survey disaggregates the dataset by agency, it does not disaggregate it by recipient country, so we cannot analyse flows to LICs. However, an internal dataset the OECD shared with the authors does disaggregate by recipient, though not by agency, only by donor. For example, it has data on the US, but it is not possible to see the split between OPIC and USAID. We used the internal dataset, as we were interested in the recipient country. If we had focused on agencies at this stage, Germany's Kreditanstalt für Wiederaufbau (KfW) and Denmark's Investment Fund for Developing Countries (IFU) would have been larger than France's AFD and Proparco.

2. The three largest blended-finance institutions in LICs

The top three institutions in each category are largely the same as the above list. The only addition is Norway. The Netherlands is the fourth-largest bilateral actor in LICs and does not make the cut, even though it is a larger mobiliser in LICs than the regional banks. Note that only two regional banks mobilise in LICs. The ADB does not have any mobilisation in LICs, although there are LICs among its recipients.

Table A2 Largest blended-finance actors in LICs

Actor	Total BF (2012-2015)	Category
MIGA	661,926	MDB
France	546,304	Bilateral
US	502,210	Bilateral
IFC	326,948	MDB
PIDG	191,608	N/A
IBRD/IDA	171,000	MDB
Norway	107,721	Bilateral
Netherlands	78,058	Bilateral
EIB	73,101	RDB
AfDB	62,850	RDB

Source: see footnote 92.

3. Thus, the final list is:

a. MDBs: **MIGA, IFC** and **IDA**⁹⁴

b. RDBs: **EIB, ADB** and **AfDB**

c. Bilaterals:⁹⁵ **US (OPIC), UK (CDC), France (AFD/Proparco)** and **Norway (Norfund)**

94 Because of the different country focus of the IDA and IBRD, we assume that IDA is the largest donor in LICs.

95 Using the public dataset, we can analyse the relative sizes of agencies in total (although not by recipient). In France, AFD and Proparco are of similar importance, while in the other countries, bilateral DFIs are by far the biggest mobilisers. We thus selected only the DFIs (OPIC and CDC Group).

Annex 2 Data-collection methodology

Introduction

Comparable and good-quality granular data are not readily available to enable a nuanced analysis and understanding of how much ODF is invested in blended finance and what private finance this investment is mobilising, disaggregated by instrument, sector and country. Consequently, we have had to build our own database to try to paint a granular picture.

Our objective was to collect data on the amount of ODF invested to mobilise private finance by our 11 selected institutions. Our key assumption was that not all MDB and DFI activities were aimed at mobilising private finance, so using the full commitment of an MDB or DFI overestimated the funds used for blended finance.

For the purposes of our quantitative analysis of the landscape and in light of the data available, we focused on the strategic use of official development finance⁹⁶ to mobilise additional⁹⁷ private finance for development purposes. In practice, this meant we measured institutions' funding for projects that aimed to directly mobilise private finance, proxied by the institution's commitments.

To get a detailed picture of the institutions' commitments, we aimed to collect as much of the disaggregated data as possible. Specifically, the data had to be detailed enough to map which countries received the financing, in which sectors, using which instruments. To obtain this level of disaggregation, we used publicly available project-level databases provided by the institutions, where available (Table A3), and screened individual projects to determine whether or not they aimed to directly mobilise private finance (see below for methodology) to build our ODI blended-finance commitment data.

Due to data availability issues, and to ensure good data coverage and coherence while ensuring sufficient coverage for trend analysis, we limited the datasets to 2013–2017. For many institutions, public disclosure of project information was lagged for confidentiality reasons, which meant that more recent projects might not have been disclosed. Consequently, the picture for 2017 was not complete at the time of compilation. Thus, we excluded 2017 from those parts of the analysis that dealt with annual averages. For AFD, Proparco and the ADB, we only had 2016 data.

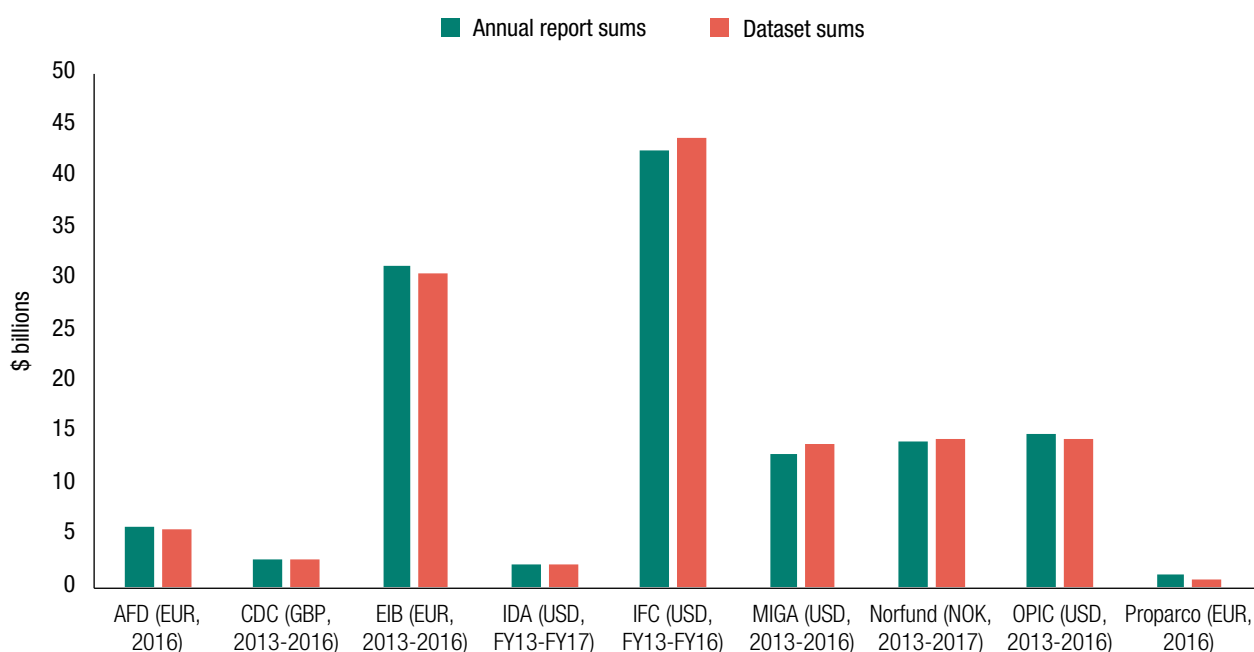
In an attempt to verify the completeness of the individual institutions' databases, we compared total annual commitments in the project databases with those in the institutions' annual reports. Figure A1 compares the total annual sums from our database with the numbers from annual reports. Although the numbers are not identical, they are roughly in the same ball park, suggesting the projects covered largely reflect total operations. This means we can be reasonably confident in the disaggregated database we have built.

⁹⁶ This is essentially the official finance subset of the OECD definition on the input side and includes concessional and non-concessional finance (i.e. MDB and DFI own-account resources). Our work excludes analysis of private development finance.

⁹⁷ An assessment of additionality is beyond the scope of this research.

Table A1 Project-level databases, by institution

Institution	Database
ADB	ADB has a separate dataset on projects involving commercial co-financing (data.adb.org/dataset/projects-involving-commercial-cofinancing-2016/resource/cccac7be-de31-4990-8361-9745d438f7de). Although the data are not at project level, we were able to obtain country-level totals.
AFD, Proparco	The agencies shared with us an internal non-public dataset where blended-finance projects were already identified.
AfDB	We were not able to obtain sufficient project-level data to conduct an analysis.
CDC	IATI dataset (iatiregistry.org/dataset/cdc-201217)
EIB	EIB website (www.eib.org/projects/loan/list/index.htm)
IDA	World Bank website (datacatalog.worldbank.org/dataset/world-bank-projects-operations)
IFC	World Bank website (finances.worldbank.org/Projects/IFC-Investment-Services-Projects/efin-cagm)
MIGA	World Bank website (datacatalog.worldbank.org/dataset/miga-project-portfolio)
Norfund	Norfund shared with us a confidential internal dataset with flow data at project level.
OPIC	We used the Center for Global Development 'scraped' OPIC portfolio dataset (www.cgdev.org/media/opic-scraped-portfolio-dataset), which captures flow data by project.

Figure A1 Comparison of total annual commitments, project-level datasets versus annual reports

Source: Individual institutions' annual reports and the institutions' public project-level databases.

Table A2 Exchange rates

Currency	2013	2014	2015	2016	2017
EUR	1.377614	1.211023	1.086653	1.052255	1.199861
GBP	1.657413	1.558642	1.476337	1.23321	1.350291
NOK	0.164767	0.133856	0.112942	0.115646	0.121898

Note: 1 unit of currency = \$ value.

In practice, because the raw data vary in coverage, typology (in terms of instrument, sector, region, etc.) and definition, they are not fully comparable. However, they represent a good proximation. All findings based on the collated dataset should be treated as estimates, rather than exact results.

Standardising datasets

Because of varying reporting standards, the institutions' datasets are not always directly comparable. To make them comparable, we had to standardise the instruments, sectors and values in US dollars. Values were calculated to US dollars from their original currency, based on the exchange rate on 31 December in the year of commitment (Table A4).

Instruments

- Any investment in a fund was classified as 'funds', regardless of whether the instrument used was debt, equity or otherwise.
- Projects classified as risk management (at IFC) and risk participation (at CDC) were grouped into the 'risk management' instrument.
- For projects where multiple instruments were used, we applied the instrument classification used by the institution in its database.

Sectors

- We customised sector classification to translate institutional classifications into a common system for comparison and analysis. This was approximate (lowest common denominator) to allow automatic translation from institutions' groupings, without manual identification (Table A5).

Identifying blended-finance commitments

Identification was carried out at project level. For each project we identified whether the commitment was used to mobilise private finance or not. To create comparable results across institutions, and to ensure reproducibility, we used a standardised methodology for all institutions.

We made the following assumptions when assessing whether individual projects were identifiable as blended finance:

General

1. We assumed all projects *intending* to mobilise private finance were blended finance. Without detailed information on investments, we were unable to determine whether projects did mobilise any private finance. We did not attempt to assess additionality, as this was beyond the scope of this exercise.
2. Only non-sovereign operations can be blended finance. We excluded all sovereign operations, as we assumed that these did not involve private financiers.

Table A5 Consolidated sector classifications

New classification	AFD and Proparco*	CDC	EIB	IDA	IFC	MIGA	Norfund	OPIC
Banking and finance	24030-25020	Financials – commercial banks	Credit lines	Banking institutions	Financial institutions	Banking	Banking	Financial services
		Financials – consumer finance		Other non-bank financial institutions		Capital markets	Financial services	
		Financials – diversified financials				Financial markets	Microfinance	
		Financials – microfinance – institutions				Financial services		
Extractive sectors	32210-32268		Oil and gas	Oil and gas	Oil, gas and mining	Mining		Extractives
			Other energy and extractives	Other energy and extractives		Oil and gas		
Infrastructure	21010-23640	Information and communications technology (ICT) – telecoms	Composite infrastructure	Energy transmission and distribution	Infrastructure	Infrastructure	Energy	ICT
			Infrastructure	Non-renewable energy	Telecoms, media, and tech	Power	Infrastructure	
			Solid waste	Other ICTs		Solid waste management		
			Telecoms	Other transport	Telecoms	Telecoms		
			Transport	Power	Transport	Transport		
			Urban development	Railways	Water	Water		
			Water, sewerage	Renewable energy – hydro/solar/ wind	Water and wastewater	Water and wastewater		
				Rural and inter-urban roads				

New classification	AFD and Proparco*	CDC	EIB	IDA	IFC	MIGA	Norfund	OPIC
Other/Multisector	Everything else	Financials – funds			Funds		Investment funds	General
					other			Humanitarian assistance
Productive sectors	31110-32182	Agribusiness and food	Agriculture, fisheries, forestry	Fisheries	Agribusiness and forestry	Agribusiness	Agriculture	Agriculture
	32310-33210	Consumer – general	Industry	Forestry	Manufacturing	Chemicals	Food and agribusiness	Hospitality and tourism
		Consumer services	Services	Other agriculture	Tourism, retail and property	Manufacturing	Manufacturing	Industrial
		Industrials				Manufacturing and services	Other industrial partnerships	Real estate
		Real estate				Services	Other services	Retail
Social sectors	11110-16064	Education – core education	Education	Central government	Health and education	Tourism	Tourism	Services
		Healthcare – healthcare providers and services	Health	Health				Healthcare
		Healthcare – life sciences tools and services		Other public admin				
				Public admin, transport				

Note: * The AFD/Proparco dataset uses CRS purpose code classifications. Codes in the table refer to a range of purpose codes. Sectoral classification is not available for the ADB. These have been classified as ‘unknown’ in the dataset.

Instruments

3. All projects involving **direct equity** in private companies were treated as blended finance – we assumed that the motivation behind direct investment was to attract further capital from private investors.
4. All projects involving **guarantees and insurance** (to the private sector) were treated as blended finance – we assumed that the intention of the guarantee/insurance was to unlock a private investment that would otherwise not have been made.⁹⁸
5. Projects involving **investments in funds** were treated as blended finance *if* the fund also involved other private investors. If the fund was only financed by DFIs or other public sources, we did not classify the project as blended finance. In cases where no information on the fund's investors was found, we assumed it included private investors (as there tends to be more information on DFI-only funds).
6. Projects involving **lines of credit** were treated as blended finance *if* the financial intermediary had to cover some of the cost of the sub-loans, take on some of the risk or provide some additional financing on top of the credit line. In practice, in our data, the EIB was the only institution to use this instrument and it does not disclose in its project descriptions the extent of the sub-loans it covered.⁹⁹ We thus treat all the projects as blended finance, as long as they go to a private-sector intermediary.
7. For projects involving **loans**, identification was more complicated. First, if the project description explicitly stated the loan was in the form of subordinated debt, B-loan or similar, we classified the project as blended finance. Where this information was not available, we compared the commitment of the institution to the total project cost. If the total project cost was higher than the commitment, unless there was any specific information suggesting the co-financer was not a private investor, we classified the project as blended finance. Note that this applied even if the co-financer was the investee/lending company. For CDC Group and Norfund, for which no information was available for total project cost, we assumed loans were blended finance.

Table A6 illustrates the assessment process through project examples, highlighting the differences.

In total, 72% of the projects were classified as mobilising.¹⁰⁰ The majority of projects not identified as blended finance were EIB and AFD sovereign projects, excluded on the basis of assumption 2, above. Among the remaining projects not identified as blended finance, most were IFC projects. These were often projects involving direct debt financing to a financial intermediary. Figure A2 shows the breakdown of mobilising and non-mobilising projects. The share is slightly lower for LICs only (66%).

98 Note that some MIGA projects provide guarantees to public entities, such as DFIs. These are not marked as blended finance, on the basis of assumption 2 (public-sector recipient).

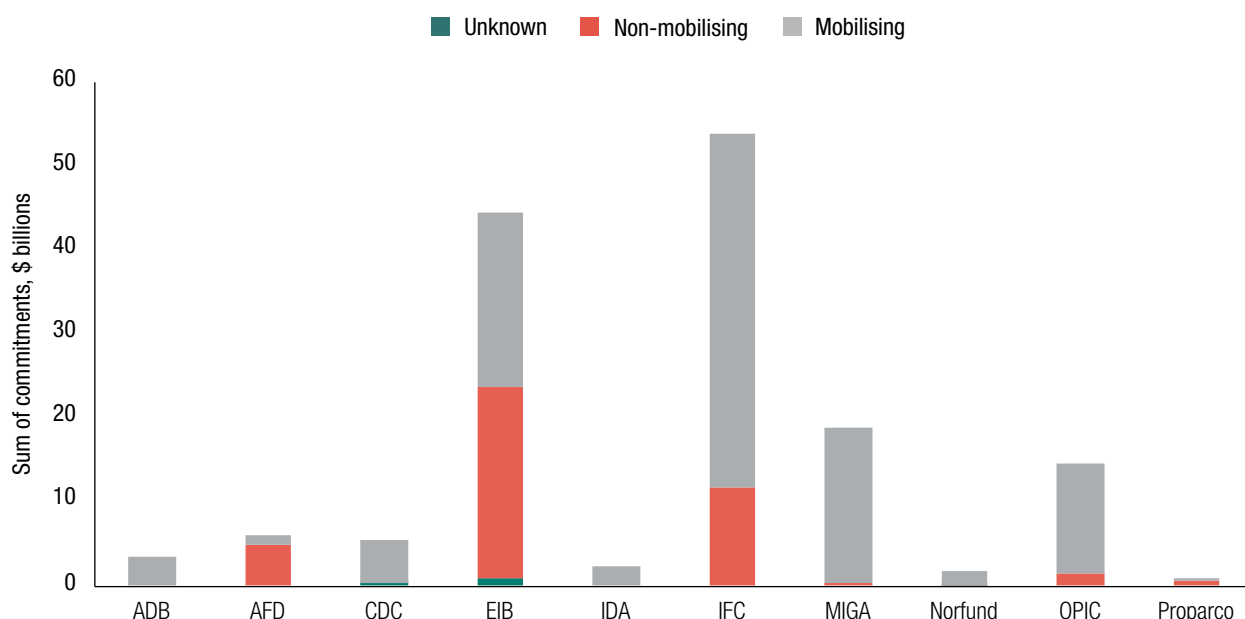
99 Although France and Norway reported the use of lines of credit in the OECD survey, we were not able to identify these from the project descriptions in the project databases provided to us.

100 This section excludes IDA sovereign lending.

Table A6 Examples from the blended-finance assessment process

Instrument	Institution	Project & amount of commitment recognised in ODI database [Project ID/name]	Classified as blended finance?	Why?
Equity	IFC	\$22 million equity investment in Cimenterie de Lukala , a private cement manufacturer in the Democratic Republic of the Congo [ID: 36898]	Yes	All direct equity projects are classified as blended finance
Guarantee	MIGA	\$2.2 million guarantee to the Burundian coffee operating company Budeca SA [ID: 13502]	Yes	All guarantee projects are classified as blended finance
Funds	CDC	\$17 million investment in the EuroMena III investment fund [ID: GB-COH-03877777-F312701]	No	The EuroMena III investment fund is only financed by DFIs (CDC, IFC, DEG, Proparco), and no private investors were identified
	CDC	\$11 million investment in the Catalyst II investment fund [ID: GB-COH-03877777-F315001]	Yes	The fund is financed also by other private investors
Line of credit	EIB	€70 million credit line to Development Bank of Ethiopia for on-lending to SMEs [Name: LEASING AND LENDING FOR SMES]	No	Financial intermediary (Development Bank of Ethiopia) is not a private-sector entity; the signatory to the loan is the Federal Democratic Republic of Ethiopia
	EIB	€20 million credit line to AccessBank Azerbaijan for on-lending to SMEs [Name: ACCESSBANK AZERBAIJAN LOAN FOR SMES II]	Yes	Financial intermediary (AccessBank) is a private bank
Loan	IFC	\$20 million A loan ^{<?>} to private Armenian bank Inecobank to support its acquisition of another bank [ID: 37196]	No	Total project cost (\$20 million) is covered by the IFC – no other sources of finance are involved
	IFC	\$100 million A loan to Argentinian company Telecom Personal to support deployment of nationwide telecom network [ID: 36171]	Yes	Total project cost (\$600 million) is not covered by the IFC. Project description mentions mobilisation from B Lenders/ parallel loans of up to \$400 million

Figure A2 Breakdown of projects by mobilising status



Note: 'Unknown' implies insufficient evidence was available in project documents to assess status.

Income classifications

World Bank income classifications (LIC, LMIC, UMIC, HIC) were used to classify countries. We used individual classifications for each project, based on the classification of the recipient country on the date of the commitment.¹⁰¹ Because some countries were reclassified during the period under analysis, two projects to the same country (but at different times) can have different income classifications. This is in contrast to the OECD mobilisation survey, for example, which uses a single classification per country – this can cause numbers to diverge.¹⁰²

101 World Bank income classifications are adjusted every July (the start of the World Bank Financial Year (FY)), based on its GNI per capita the preceding year. A country has a certain income classification from July to June. For example, Kenya was reclassified as an LMIC in July 2015 (at the beginning of FY2016), before which it was classified as an LIC. For an investment in Kenya in August 2015 (FY2016), we classified the project as an LMIC, but for an investment in June 2015 (FY2015), we classified it as an LIC. For some institutions, information on date was not included, but year was. In these cases, we treated the commitment as having been made on 1 January of that year.

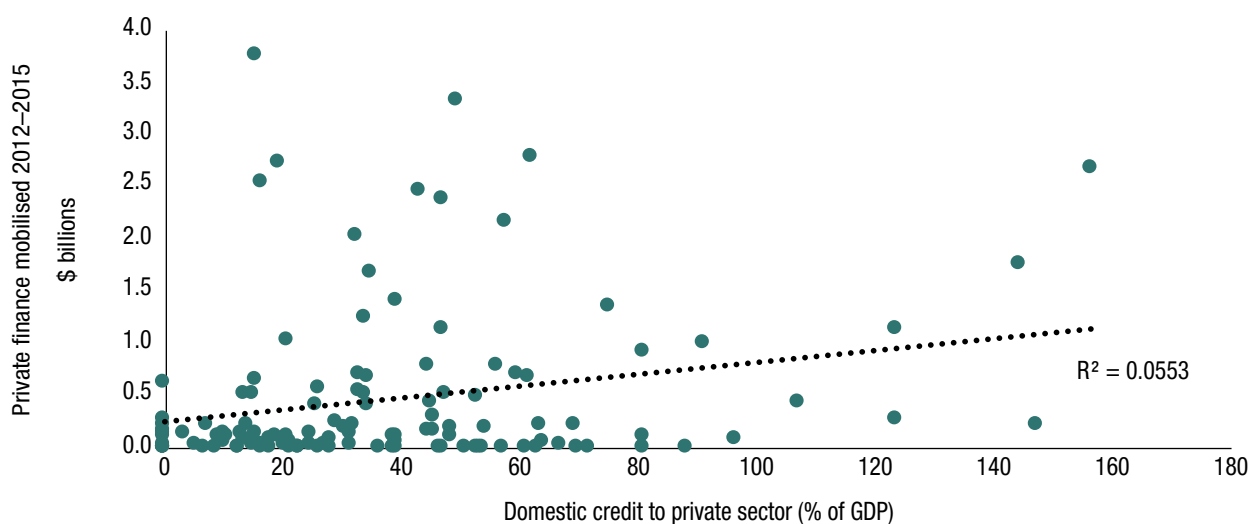
102 Although we could see that the OECD applied a single income classification to a country throughout the period, it was not clear what its methodology was; some countries were classified according to their income classification at the start of the survey period and some at the end of the survey period.

Annex 3 Scatter plots

Figure A3 shows a slight positive correlation between financial depth and private finance mobilised. To some extent, this is explained by the slight positive correlation between financial depth and GDP per capita, but also the fact that around one third of the private finance mobilised is in the banking and finance sector.

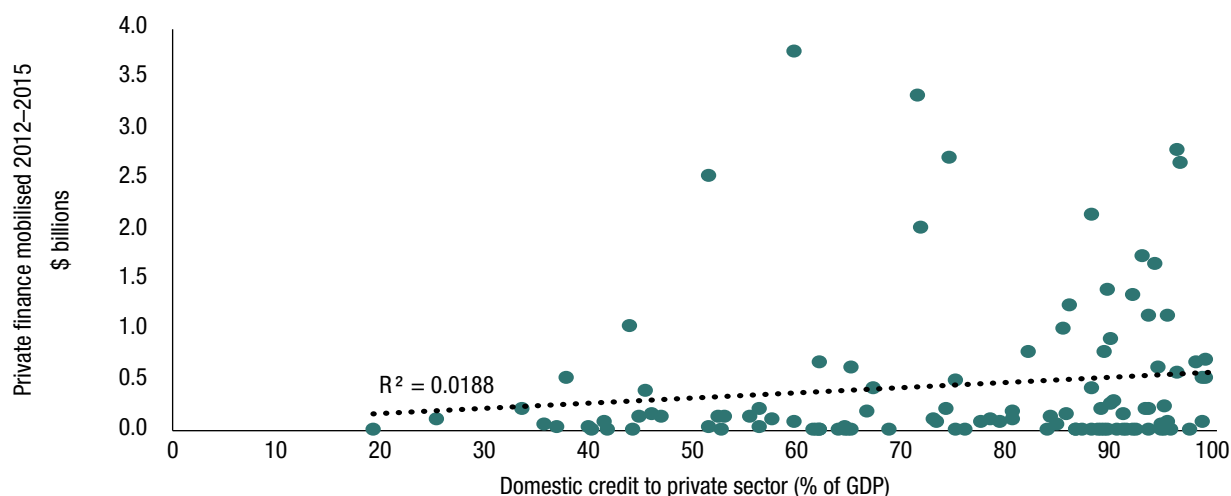
Figure A4 shows a slight positive relationship between the Human Assets Index¹⁰³ and the amount of private finance mobilised, probably because the Index is very closely correlated with GNI per capita.

Figure A3 Relationship between private-finance mobilisation and financial depth



Source: Benn et al. (2017), World Bank Development Indicators (FS.AST.PRVT.GD.ZS).

Figure A4 Relationship between private-finance mobilisation and the Human Assets Index



103 www.ferdi.fr/en/indicator/human-assets-index



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