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Policy Brief

G20-BACKED BLENDED FINANCE FUND-OF-FUNDS AND HOLISTIC RESOURCE PLATFORM TO HELP LOW-INCOME AND VULNERABLE

Task Force 9

Global Cooperation for SDG Financing

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Abstract

The annual United Nations Sustainable Development Goals (SDGs) financing gap for developing countries is humungous. Blended finance has fallen short. Moreover, money alone cannot address development challenges. To achieve the SDGs by 2030, blended finance has to be combined with capacity-building, technology transfer and institutional backup to help particularly low-income and vulnerable economies (LICs/LDCs). Therefore, we propose a G20-supported blended finance "fund-of-funds and holistic resource platform" lodged in a reputed multilateral organisation for crowding in private funds and blending complementary resources, with country focus, thereby enhancing the creditworthiness and productivity of SDG projects in LICs/LDCs. The platform can thus help blended finance evolve into a "blended resource".

Challenges

The United Nations Sustainable Development Goals (SDG) have set an essential but ambitious agenda. Many nations, especially low-income countries/least developed countries (LICs/LDCs), are likely to fall short of achieving the SDG targets by 2030 (Kitzmueller, Stacy and Mahler, 2021; Shulla et al., 2021; UN, 2021). The ramifications of the COVID-19 pandemic and the Ukraine crisis have led to substantial time being lost in converging efforts to help LICs/LDCs meet the SDGs even as these crises have considerably eroded pre-pandemic period gains.

A significant concern for developing countries is the annual SDG funding gap, which, post the COVID-19-triggered global crisis, was projected to have ballooned from the existing US$2.5 trillion by an additional $1.7 trillion (OECD, 2021). With falling tax revenues and dwindling external financing, developing countries need to attract a fair share of the $379 trillion-worth of global financial assets to bridge/narrow the SDG financing gap (OECD, 2020a). LDCs particularly are facing "widening" SDG financing gaps. They have not been able to attract significant private finance in "development finance interventions" as private funds considering LDCs for investment, have been keen more on sectors such as finance and energy with better "profitability prospects" (OECD/UNCDF, 2020). Mobilisation of private sector finance from development/multilateral financial institution (DFI/MFI) investments in LICs is also minuscule (Attridge and Engen, 2019).

Blended finance, which combines concessional and non-concessional funding and helps forge partnerships including between public and private financial entities, can play a crucial long-term role (OECD website) in attracting private funds to SDGs to partially address the SDG financing gap. However, blended finance has not been flowing to LICs/LDCs significantly as finance is less productive without the timely availability of complementary resources.

LICs/LDCs/Global South will have to firm up an integrated incentive mechanism to channel an additional $500 billion in private funding annually into the environmental, social and governance (ESG) investment basket (Hatashima and Demberel, 2020).

While funding instruments, including blended finance, address certain SDGs, money alone cannot solve issues related to several SDGs (e.g., Goal 1-poverty, 6-clean water and sanitation, 4-quality education, etc.) of vital importance to LICs/vulnerable countries (Roth, 2017). For timely and better outcomes, finance needs to be complemented by technology transfer and capacity-building. Therefore, the “blended finance” concept will have to evolve into what we term as “blended resources” through the integration of the above-mentioned complementary resources, and help the LICs/LDCs meet the SDGs by 2030.

However, a major challenge is ensuring near-market-rate returns on investments in SDG projects in LICs/LDCs. Moreover, the creditworthiness of borrowers from LICs/LDCs/vulnerable economies as well as the sovereign credit rating of these countries remain poor (Sachs, 2021), due to which private funds shy away from investing in SDG projects in these countries. Therefore, a “project-to-project” approach to seeking finance from these countries is not the best way. A holistic approach is required through a dedicated multilateral platform to cater to SDG-related requirements of LICs/LDCs that crowd in more private funds, improve the effectiveness of finance for SDG projects and enhance the return on such investments.

Proposals for G20

The Global South, hampered by financial and capacity constraints to meet the SDGs by 2030, confronts complex developmental challenges that can be addressed effectively only through an optimal mix of innovative financing mechanisms, as well as complementary resources, including the development of skills and technology.

The need of the hour is to take forward the blended-finance concept - which is essentially the deployment of development finance from governments, DFI/MFI and philanthropic organisations strategically and catalytically mobilising additional capital that is non-concessional in nature from private and public sources in a manner that mitigates risks while ensuring sustainable development (See Table 2 in Appendix for details).

The potential of blended finance to meet the SDGs and implement the Addis Ababa Action Agenda has been recognised by the G20 Osaka Declaration (G20, 2019). Moreover, the G20 Sustainable Finance Roadmap specifically mentions the need to help the Global South develop blended-finance instruments to achieve the Paris climate agreement objectives and national SDG plans (G20, 2021). The G20 needs to back these up by helping build an efficient blended-finance and holistic-resources ecosystem globally that leverages network effect strengths.

The blended-finance segment has witnessed a fairly steady and notable growth over the last decade or so despite a decline in some years during that period (see Table 3 and Table 4 in Appendix). The Global South regions that have benefited considerably from blended finance include Sub-Saharan Africa and South Asia, while the significant beneficiary sectors include energy and financial services. This innovative financing mechanism caters to many SDGs, especially those linked to SDG17-partnerships, SDG13-climate action and SDG9 infrastructure, and in the process helps generate productive employment, and reduces inequality and poverty (See Table 4 in Appendix for details). However, there is a long way to go before blended finance becomes a force to reckon with in the development partnership ecosystem.

The generally accepted/used definitions (See Table 2 in Appendix) of blended finance, with a focus on funding sources of varying costs and risk appetite, pose challenges in optimising the full benefits of the concept of blending. The absence of adequate complementary resources renders finance less productive in achieving SDGs. Besides, SDG projects as such have low credibility for financiers making fund flows grossly inadequate in that direction.

Therefore, we suggest a new holistic term “blended resources”, incorporating complementary resources such as capacity building as well as designing and transferring technology to help the LICs/LDCs (see UNDESA website and World Bank website in the Reference section for definition of LDC and LIC, and the related details) address their development challenges while pursuing the SDGs by 2030. Effective implementation of this holistic concept necessitates the setting up of a multilateral coordinating mechanism/platform. Moreover, given the multitude of challenges faced by LICs/LDCs, there is a need for concerted global efforts to provide them concessional finance/grants and to deploy innovative solutions that are tuned to address their unique needs and absorption capabilities.

To enable the greater contribution of blended finance towards addressing the SDG financing gap in LICs/LDCs, we propose a “G20-backed Blended Finance Fund-of-Funds and Holistic Resource Platform” (henceforth referred to as “the Platform”).

The Platform could facilitate the pooling of concessional/SDG-oriented public aid and/or private philanthropic finance as well as non-concessional/commercial public and/or private funds to create a fund-of-funds, and further blend them with adequate relevant complementary resources by assisting in the development of capacities and technologies for the identified SDG projects. This exercise will be crucial because when it comes to meeting the “basic” SDGs such as sanitation, health and primary education in LICs/LDCs, a focus on finance alone could prove to be unproductive and lead to sub-optimal outcomes. Non-financial resources like capacity building and technology development/transfer would, therefore, be essential to help those economies realise the SDGs in a timely, inclusive and effective manner (Also see Figure 1).

	Finance (F)		Non-finance (NF)
F1	Philanthropy	NF1	Philanthropy-based skill-building and innovation/technology development initiatives
F2	Government schemes (largely subsidies)	NF2	Government schemes for the development of capacity/skills, technology
F3	ESG oriented funds	NF3	CSR funds for skilling and technology dissemination
F4	Official Development Assistance (ODA)	NF4	ODA for skill development and technology dissemination
F5	Debt-based funds	NF5	NGOs or specialised agencies for skill/technology development
F6	Market-oriented funds	NF6	Supply by private skill development agencies at market rates

Expected outcomes
More productive finance customised for the needs of LICs/LDCs
Crowding-in private funds
Risk-mitigation through guarantee
Pooling and transfer of technology and skill-sets
Time-bound achievement of SDGs

Figure 1: The Platform - From "blended finance" to "blended resource"
Source: Authors' representation

From a “project-to-project” basis to a multilateral platform

The blending of finance should be carried out at a multilateral level by the proposed Platform as against the current practice of developing blended-finance projects on a “project to project” basis (Also see footnote 1). The Platform should be recognised as a global body for philanthropic organisations, public and private sector funds, as well as development cooperation and aid agencies of governments to finance capacity-building programmes and technology partnerships that can help LICs/LDCs.

Location

SDGs are a “global public good”. Any laxity in achieving the goals in any corner of the globe would derail the whole set of targets. Hence the exigency in helping LICs/LDCs and vulnerable economies reach SDGs targets on time. Taking into account this urgency, the Platform needs to be part of an existing multilateral institution with an established track record of providing support to developmental projects in LICs/LDCs, as well as with expertise in the promotion of SDGs (Also see footnote 2). It should then recruit specialised staff with a proven ability to deliver quick results and have working relationships with concessional and non-concessional funding organisations, skill development agencies and commercial entities providing technology solutions. Such a strategy can in turn help the Platform be a global network of providers of finance, skill-sets and technology.

Local Focus

Setting up local representative offices in LICs/LDCs and hiring local staff can help the Platform take into account their languages, cultures, types of government support, the stages of progress in each SDG, the local priorities, the existing indigenous capacity, the participation of NGOs - both national and international, ODA support and local government schemes with a focus on SDGs in order to develop unique methods and customised solutions to address SDG-related issues of these countries (Also see footnote 3).

Enhancing credit rating

The low sovereign credit ratings assigned by global rating agencies to developing countries, especially to the LICs/LDCs, increase their borrowing costs and make it difficult for them to attract investments on account of the perception of very high risks (Sachs, 2021). This is all the more so when investment is for SDG projects. However, when a multilateral agency like the proposed Platform takes up the responsibility of a holistic blending of finance and other relevant complementary resources such as skill development and technology development/transfer (or “blending of resources”), it acts as a risk-mitigation measure that helps enhance the credibility and creditworthiness of SDG-related projects in LICs/LDCs as well as their rating. The role of rating agencies as stakeholders and their experience in risk modelling in this exercise is crucial as commercial and non-commercial funds take into consideration risk factors including project finance default-related risks as well as the rate of recovery (OECD, 2020b). In the context of the Platform’s proposed focus on LICs/LDCs, it is also vital that the Platform facilitates greater interactions between rating agencies and DFIs/MFIs (Also see footnote 4).

Implementation of the blended resource concept could even help in ensuring market-equivalent financial returns to financial sources which flow into SDG financing largely or purely for commercial reasons.

The rollout of the Platform (with the basic features mentioned in Table 1) can help LICs/LDCs meet their immediate requirements related to recovery from the COVID-19 pandemic and the Ukraine crisis, particularly with a view to developing and strengthening the health infrastructure. Such an approach could also support their social and economic development programmes over time, on a self-sustaining basis.

Table 1: Basic features of the Platform

Function	Method of implementation	Challenges	Expected outcome
Blending of resources	Instead of project-to-project blending of finance, the Platform should consider raising funds and complementary resources directly or through its local offices in identified countries and blending them at the multilateral level. These blended funds and resources can then be made available to select SDG-related projects in LICs/LDCs.	Incorporating risk-mitigation strategies including investment guarantees and political risk insurance and getting the necessary buy-in from actors including DFIs, governments, philanthropic organisations and private investors.	Greater effectiveness by rendering finance more productive and efficient. The blending of complementary resources would suit the requirements of LICs/LDCs.

Function	Method of implementation	Challenges	Expected outcome
	The Platform could also help determine the rates at which funds are made available, as well as the allocation of other complementary resources including technology.		
SDG focus	The Platform would offer dedicated SDG-focused support to projects, including blending of finance, as well as complementary resources for the benefit of LICs/LDCs.	Lack of capacity and awareness about SDGs; absence of legal and institutional arrangements for effective governance; inadequate data; and poor infrastructure including digital connectivity at the local level can delay efforts to localise SDGs.	This will help these LICs/LDCs achieve the SDGs and the related targets in a time-bound and systematic way.
Project preparation and training	The Platform should facilitate handholding exercises including project preparation, capacity building and technology development through its local offices and thus support local stakeholders	Capacity constraints at the local level; difficulties in ensuring an inclusive approach including maintaining gender equality in project preparation and training.	This can help LICs/LDCs overcome the challenges related to inadequate capacity and experience in project preparation and implementation.
Making available bespoke funds and complementary resources through close coordination with local governments	The funds and resources will be tailor-made to suit the national/SDG priorities (including those concerning the green and digital transition in addition to providing special attention to MSMEs and women) of LICs/LDCs. Customisation of funds and resources will follow an exercise where the SDG-related schemes – including those related to	Lack of effective governance for project implementation at the local level as well as poor local-national level coordination adds to the risk factors; inadequate data for analysing local requirements and for appropriate fund allocation.	This can help the countries achieve SDGs at the earliest, make economic growth more inclusive and equitable, as well as recoup the losses on account of COVID-19 and the Ukraine crisis. The custom-made funds and resources will save costs and time during project implementation.

Function	Method of implementation	Challenges	Expected outcome
	vocational training as well as technology incubation – of the LICs/LDCs will be identified to find and use local human and technology resources.		
Optimal structuring of blended finances and resources	The Platform would ensure that financial resources are mobilised from various sources differing in cost, objectives and maturity mix. The Platform would also contribute "seed capital" to the blended-finance pool to attract and leverage philanthropic, subsidised and "marked to market" private capital.	Difficulties in catering to the interests of different stakeholders; problems in arranging "patient capital" given the various risks involved.	This exercise can help avoid market distortions, while attracting a greater quantum of financial resources.
Guarantee for funding SDG projects	The Platform could also provide a guarantee for SDG-related financing in LICs/LDCs.	Addressing political risks and loan default risks; inadequate local-level data including on SDG reporting.	This will be a risk-mitigation strategy to attract private investors in SDG projects with perceived high risks.
Serve as Technology Bank for SDGs in LICs/LDCs.	The Platform can procure/transfer technology to an in-house pool for distribution to SDG projects in these countries. The necessary technology-transfer fees including lump-sum payments and royalties can be provided by the Platform, with rights for unlimited dissemination.	"Digital divide and technology divide" and inadequate capacity to use technologies even if transferred to the local level in LICs/LDCs; developing and protecting indigenous technologies; assessing technologies to ensure their local appropriateness.	This will enable technology and skill sets to be made available to these countries at a very low cost, as a complementary resource to finance, and in turn, render investment in SDGs in these countries more productive and SDG projects more viable. Such a move would also attract more market-related capital which would otherwise not flow into

Function	Method of implementation	Challenges	Expected outcome
			SDG projects in these countries.

Source: Authors' representation

Additional major tasks of the Platform:

a) The Platform could help monitor MDBs/DFIs, including their efforts in early-stage market creation as well as the timing of their exits, in social and environmental projects, considering the leading role of MDBs/DFIs as anchors in such risky projects where private investors tend to play a supporting role.
b) It could ensure the required balance in concessional and non-concessional funding by collating lessons from both successful and unsuccessful blended-finance projects on account of the risks stemming from high levels of either concessional or non-concessional finance in a blended package (Sierra-Escalante and Lauridsen, 2018). These measures could help address risks related to innovative environmental and social projects with scalable potential in a manner that can generate healthy returns.
c) It could dynamically compile blended finance-related policy and regulatory restrictions as well as suggestions for effecting reforms including with regard to their effective functioning and scaling.
d) It could also gather recommendations from across the world that can help the LICs/LDCs build capacities to analyse ways to eliminate ineffective subsidies (those that do not generate "social returns" that are measured not just in financial terms but also looking into the social/environmental impact) to the private sector, in addition to finding ways to prevent the public sector from taking excessive risks while undertaking social and environmental projects (UNDESA, 2016; Spiegel, et al., 2021).
e) Further, it could look at best practices in blended finance to help put in place a favourable blended-finance policy and regulatory regime across the world as well as to harmonise the relevant standards.
f) It could facilitate pilot projects of environment, social and governance (ESG)-compliant accelerated funding mechanisms in LICs/LDCs with a view to assessing their impact (Also see footnote 5).

Concluding Remarks:

We are midway in the pursuit of SDGs (SDG 2030 Agenda) initiated in 2015. The pandemic shaved off two full years, and its fallout lingers. LICs/LDCs and vulnerable economies face distinct problems in the pursuit of SDGs. “Finance with a purpose” is crucial, and the concept of blended finance evolved to crowd in private investment for the cause of SDGs, especially in developing countries and LDCs. However, blended finance for SDGs has not been flowing to these countries in any significant way. This is primarily because of the absence of adequate complementary resources. In fact, finance alone cannot address the sustainable development of these nations. Complementary resources like the development of capacity and technologies are equally necessary. Moreover, the “project-based” pursuit of blended finance has not been seen to be effective in these countries.

This paper, therefore, proposes a multilateral platform-based blending of finance and other complementary resources, with a close focus on the specific requirements of these countries, for effectively expediting the efforts to achieve the SDGs. A multilateral platform lodged in a reputed established multilateral institution like the World Bank would serve the purpose of flattening the risk curve for the LICs/LDCs and vulnerable economies, and ensure that more and more private funds flow in for the cause of meeting the SDG-related targets in these countries. The effectiveness of finance in these countries is also expected to be substantially enhanced when a holistic approach is pursued by blending all the resources rather than finance alone.

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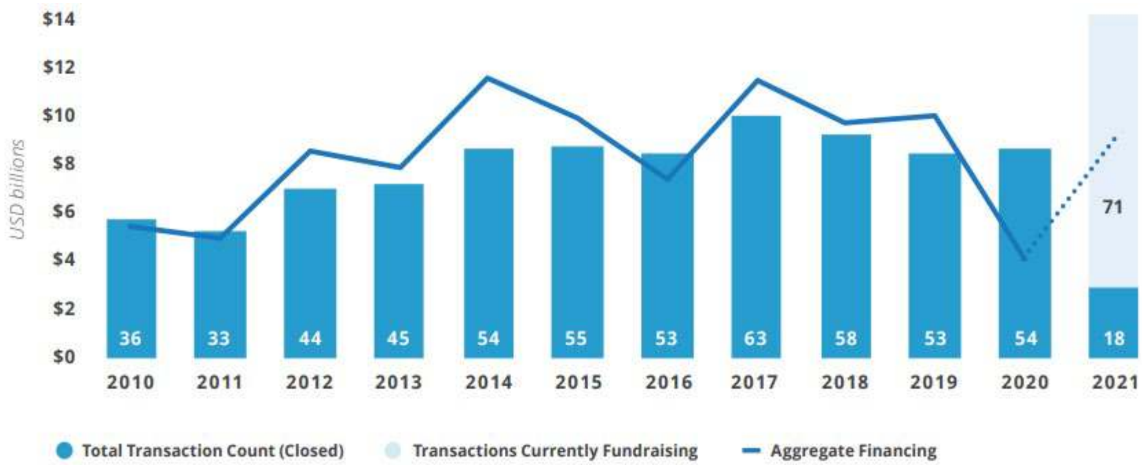
Appendix

Table 2: Blended finance - definitions

Organisation / Authors	Definition
OECD	"The strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries" (OECD website).
Convergence	"The use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development" (Convergence website).
UNDP	"The strategic combination of public and/or private development finance flows (e.g., aid and philanthropic funds) with other public or private capital to enhance resources for investment in key areas such as infrastructure. Blended finance can therefore involve public-public financial partnerships as well as public-private partnerships" (UNDP, 2018).
IFC	"The use of relatively small amounts of concessional donor funds to mitigate specific investment risks and help rebalance risk-reward profiles of pioneering investments that are unable to proceed on strictly commercial terms" (IFC website).
Tonkonogy, et al.	"The use of public/philanthropic funds to mobilise multiples of additional private capital."
Attridge and Engen, 2019	"The strategic use of official development finance to mobilise additional private capital flows to developing countries to achieve the SDGs"; Also "several common attributes that feature in the various definitions, namely: (i) the use of concessional development finance; (ii) the intent to mobilise additional finance, primarily private commercial finance; (iii) some form of development impact associated with the investment."

Table 3: Blended finance market size



Source: *Convergence, 2021*

Table 4: Blended finance – some quick facts

- Aggregate blended-finance capital mobilised towards sustainable development in developing nations to date is ~ $161 billion
- The top destination for blended finance was Sub-Saharan Africa, followed by South Asia; Kenya and India were in number one and two positions in "frequently targeted" nations.
- In terms of sectors, energy had the maximum frequency, followed by financial services.
- Blending archetypes include concessional capital, technical assistance funds, guarantees or risk insurance, design-stage grant and results-based financing.
- More than half of the investors who have taken part in blended-finance transactions are from the private sector, while a quarter each were from public sector and philanthropic organisations.
- Among the SDGs, the most impacted of these goals included SDG 17 (partnerships), followed by 9 (industry, innovation and infrastructure), 8 (decent work and economic growth), 1(no poverty), 10 (reduced inequalities), 7 (affordable and clean energy), 5 (gender equality), 2 (zero hunger), 11 (sustainable cities) and 13 (climate action).
  (Source: Convergence, 2021)
- 180 blended-finance collective investment vehicles (CIVs) held assets of $60.2 billion at the close of 2017; more than 195 new CIVs were created during the 2008-2017 period.
- Most of the blended funds were headquartered in OECD countries (71%), followed by Africa (16%, half of which were located in Mauritius). Only two funds were based in LDCs.
  (Source: Basile and Dutra, 2019)

Footnotes

1. This is because it has been seen that a "fragmented" (project-to-project) approach could be "costly, process-heavy, creates assets that are too small for institutional investors and does not invite rapid replication or scaling" (One Planet Lab, 2021).

2. Being a dedicated division within the identified multilateral institution can help the Platform leverage the expertise and strengths of the former, and prevent wastage of time and effort in the so-called "reinvention of the wheel".

3. The paramount importance of country ownership being at the centre of blended finance for greater effectiveness has been recognised by studies such as Spiegel, et al. (2021). Also, integration of outcomes - including local capacity building through technical assistance - into blended-finance initiatives can benefit projects during their entire lifecycle (WEF and OECD, 2015).

4. Terming DFIs as "important actors in offering risk mitigation", OECD/UNCDF in a report on blended finance in LDCs has noted that DFIs - which play a catalytic role in mobilising investments including in fragile countries - may "need to work with shareholders and rating agencies to accept a certain level of loss, as they direct more resources to LDCs" (OECD/UNCDF, 2020).

5. Given the paucity of time to achieve the SDGs by 2030, implementation of such pilot projects is crucial to not only assess the effectiveness of initial investments but also to spur innovations in funding. Also, when ESG-compliant investments are launched from the multilateral Platform, the funding is likely to get better ratings than funds that do not have that tag and those that work on a project-to-project basis. The backing by a multilateral organisation of repute of SDG-based projects in LICs/LDCs in a holistic manner, as well as the ESG compliance would make the supported projects viable and render the funding plan attractive for private investors to tag on. Moreover, a narrow focus on short-term profits is unsustainable and could prove to be counter-productive in the long term. On the other hand, ESG-compliant funds focus on quality outcomes and social rate of return, which in turn not only pays off financially in the long run but also can be seen as a risk-mitigation strategy even in conflict zones and difficult LIC/LDC markets.