Blended Finance in the Least Developed Countries 2020

SUPPORTING A RESILIENT COVID-19 RECOVERY



OECD

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Unlocking Public and Private Finance for the Poor

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Foreword

Since 2018, the United Nations Capital Development Fund (UNCDF) and the Organisation for Economic Co-operation and Development (OECD) have collaborated on research and knowledge on blended finance in the least developed countries (LDCs), with the aim to contribute to the policy debate on blended finance by developing empirical evidence and original research on how blended finance can be best used in LDCs to mitigate risk and attract investment for the Sustainable Development Goals (SDGs).

The *Blended Finance in the Least Developed Countries, 2020* report is the second joint UNCDF-OECD report. It builds on UNCDF research and experience, OECD data and analysis, and a series of guest contributions written by a varied range of blended finance experts. The research and analysis in this report was further informed by multiple roundtable consultations held virtually during the spring of 2020. The consultations were held with a wide range of stakeholder groups, namely blended finance experts and practitioners (14 April 2020), anglophone LDCs (14 May 2020), francophone LDCs (18 May 2020) and United Nations missions in LDCs (18 May 2020).

For UNCDF, the report aligns with its mission to mobilise additional finance for the LDCs to support their social and economic transformation. The report analysis informs UNCDF's work to provide last-mile finance models that unlock public and private resources to reduce poverty and support local economic development. UNCDF manages a portfolio of risk-tolerant catalytic loans and guarantees on its balance sheet, which aim to de-risk early-stage enterprises and projects in LDCs to enable them access to additional capital. This support for "missing middle" finance in LDCs fills a unique niche in the development finance architecture. UNCDF now aims to fully capitalise its LDC investment facility to scale up this support, in its capacity as an official international support measure for LDCs. UNCDF is also establishing technical assistance facilities for two blended finance vehicles it helped establish, the BUILD Fund and the International Municipal Investment Facility, to help local partners assess, identify and prepare investments.

This report contributes to the overarching mission of the OECD Private Finance for Sustainable Development team to build the evidence base and provide policy advice on blended finance and promote dialogue between the Development Assistance Committee (DAC) and the private sector, including through the OECD DAC Community of Practice on Private Finance for Sustainable Development. This report also informs the work on blended finance, including on the OECD DAC Blended Finance Principles and Guidance, adopted by DAC members in September 2020, which will be updated in the future.

This report has been developed at an exceptionally critical juncture when LDCs are facing unprecedented pressures stemming from the COVID-19 crisis. As the Istanbul Programme of Action (IPoA) for the LDCs is coming to end in 2020, the United Nations General Assembly agreed to convene the Fifth United Nations Conference on the LDCs (LDC5) in Doha, Qatar, in January 2022. This report aims to contribute to and inform the LDC5 preparatory process and, eventually, the new Programme of Action for LDCs.

The findings and Action Agenda in this report can also contribute to the next steps in the United Nations initiative on financing for development in the era of COVID-19 and beyond, which has called for increased efforts to promote private investments in the SDGs in developing countries, including through greater support for innovative blended finance approaches in LDCs (UN, 2020[1]).

Acknowledgements

This report was jointly prepared by the United Nations Capital Development Fund (UNCDF), under the leadership of Executive Secretary Judith Karl, and the Organisation for Economic Co-operation and Development (OECD) Development Co-operation Directorate, led by Director Jorge Moreira da Silva. The two organisations remain deeply appreciative of the quality of this collaboration, which began in 2017.

The lead authors of this report are Laura Sennett, Policy Specialist, and Casper Sonesson, Policy Adviser, UNCDF, Faty Dembele, Policy Analyst, and Valentina Bellesi, Junior Policy Analyst, OECD. Many thanks to the UNCDF management team and other colleagues for their important guidance throughout the drafting process. Within UNCDF, the work was performed under the supervision of Esther Pan Sloane, Head of the Partnerships, Policy and Communications Unit. Within the OECD, the work was performed under the supervision of Haje Schütte, Head of Financing for Sustainable Development Division, and under the guidance of Paul Horrocks, Head of Private Finance for Sustainable Development Unit. The report, and Chapter 4 in particular, benefited from invaluable support on data collection from Cécile Sangaré and Tomáš Hos, OECD. The authors would also like to thank Thomas Boehler and Rafael Duque Figueira, OECD, for their engagement through the Global Partnership for Effective Development Co-operation (GPEDC). The quantitative analysis also benefited from the complementary information generously provided by Ayesha Bery, Convergence.

The team would like to extend sincere thanks to the authors of the guest contributions for sharing their experiences and expertise: Saber Hossain Chowdhury, Bangladeshi Parliament; Aakif Merchant, Convergence; Nathan Kelley and Pooja Yadav, CrossBoundary; David Hughes, Global Affairs Canada; Lasitha Perera, GuarantCo; Luigi Lannutti and Kruskaia Sierra-Escalante, International Finance Corporation; Samantha Attridge, Overseas Development Institute; Roland V. Pearson Junior, Palladium; Feisal Hussain, ThinkAhead Consulting; and Abdul-Rahman Lediju, Anders Berlin, David Jackson, Henri Dommel and Nan Zhang, UNCDF. The authors would also like to thank speakers and participants of all rounds of consultations (information on the consultations can be found in the foreword).

The report benefited immensely from comments and feedback from a group of expert peer reviewers: Rob Floyd, African Center for Economic Transformation; Ayesha Bery, Convergence; Nathan Kelly and Pooja Yadav, CrossBoundary; Marco Serena and Cecile Sorhus, GuarantCo; Luigi Lannutti, International Finance Corporation; Rohit Matthan, Multilateral Investment Guarantee Agency; Thomas Boehler, Priscilla Boiardi, Rafael Duque Figueira, Weronika Garbacz, Tomáš Hos, Rachel Morris, Cécile Sangaré and Esme Stout, OECD; Roland V. Pearson Junior, Palladium; Sharon Spiegel, Resina Katafono and Sander Hanson Glas, United Nations Department of Economic and Social Affairs; Anne Philine Kersting and Susanna Wolf, United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States; and Rajeev Kumar Gupta, Mattias Granqvist, David Jackson, Esther Pan Sloane, Bram Peters and Omon Ukpoma-Olaiya, UNCDF.

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Editorial

> "Everything we do during and after this crisis must be with a strong focus on building more equal, inclusive and sustainable economies and societies that are more resilient in the face of pandemics, climate change and the many other global challenges we face."
> *United Nations Secretary-General António Guterres*

COVID-19 threatens to undo years of progress achieved towards the 2030 Agenda by least developed countries (LDCs). Even before the current crisis, LDCs faced an uphill battle to achieve the Sustainable Development Goals (SDGs). Now, without ambitious development finance and policy responses, there is a serious risk of the SDGs remaining elusive for LDCs, and this will have a global impact. The development responses to the COVID-19 health and socio-economic crises must therefore be made with a forward-looking perspective to building forward better and greener.

Financing the recovery will require a co-ordinated multilateral response and the use of innovative tools and risk-mitigation instruments. Blended finance can help to catalyse much-needed additional resources for SDG-aligned projects that private investors would otherwise overlook. It can be used, among other purposes, to leverage digital technologies, finance small and medium-sized enterprises in the "missing middle" gap, and address market failures that prevent LDCs from financing their development needs and reaching the most vulnerable.

Consistent with findings in previous reports on blended finance in the LDCs, the latest data show that too little private finance is mobilised for investment in LDCs. Only 6% of private finance mobilised by official development finance is invested in LDCs, a percentage that has remained constant over the past three years. Positively, we have seen that in the period 2012–2018, the total amount of private sector finance mobilised annually has grown steadily in absolute terms. Also, 45 out of 47 LDCs have received private finance mobilised by official development finance (ODA) at least once. However, as projected by the OECD *Global Outlook on Financing for Sustainable Development*, the USD 700 billion drop in external finance to developing countries as a result of the COVID-19 crisis risks jeopardising the trajectory of blended finance for LDCs (OECD, 2020[2]). That is why it is critical that ODA – the most stable source of external finance to developing countries over the past 60 years, even in the face of economic crises – must be protected and leveraged to align more private finance in support of the SDGs in LDCs.

This third instalment of the blended finance in LDCs report presents an analysis and an Action Agenda for how to use blended finance to mobilise additional finance to support LDCs to build forward better from the COVID-19 pandemic. Through research, data analysis and a collection of curated guest contributions, the report aims to shed light on how blended finance can be used and scaled up to address the socio-economic challenges in LDCs today, and to build long-term resilience.

Achieving the core principle of “leaving no one behind” is key for sustainable development in the LDCs and necessitates innovative solutions to address risk and build resilience to future shocks. To advance this principle will require blended finance to focus even more sharply on supporting the development of domestic financial ecosystems and markets, designing solutions that target the last mile, improving impact measurement and transparency, and employing more systemic and transformational approaches, to catalyse larger-scale investments in country-led priorities and projects in sectors that promote an inclusive, sustainable and resilient recovery.

This report also comes as the Istanbul Programme of Action is coming to an end, and the preparations for the Fifth United Nations Conference on the Least Developed Countries (LDC5), scheduled for January 2022 in Doha, have started. LDC5 is an opportunity for LDCs and their development partners to define key priorities, agree on a renewed partnership to overcome structural challenges, and mobilise additional resources and international support measures, to enable countries to graduate from the LDC category and achieve the SDGs in the coming decade.

Blended finance, as one of the approaches in the development toolbox, should play a more strategic role in securing additional finance for LDCs to achieve these objectives. Now is the time to increase our ambition to leave no country behind, with COVID-19 serving as a powerful reminder of the interdependence among countries and the need for global solidarity to overcome the crisis. Action today must extend beyond helping LDCs to recover; investments are needed to build resilient economies and societies that bring future opportunities to all their people. We hope that this report sparks discussion about what more could and should be done, followed by urgent action to mobilise private finance for sustainable development that enables LDCs to build forward better.







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Abbreviations and acronyms

ACGF	Afghan Credit Guarantee Foundation
ADB	Asian Development Bank
AIMM	Anticipated Impact Measurement and Monitoring
CBE	CrossBoundary Energy
CDP	Committee for Development Policy
CI1	Climate Investor One
CIV	collective investment vehicle
COVID-19	coronavirus disease
CRPS	cumulative redeemable preferred shares
DAC	Development Assistance Committee
DFI	development finance institution
EAIF	Emerging Africa Infrastructure Fund
EAPD	Economic Analysis and Policy Division (UN DESA)
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
FDI	foreign direct investment
GAFSP	Global Agriculture and Food Security Program
GDP	gross domestic product
GFCF	gross fixed capital formation
GIIN	Global Impact Investing Network
GISD	Global Investors for Sustainable Development Alliance
GNI	gross national income
GPEDC	Global Partnership for Effective Development Co-operation
GTFP	global trade finance programme
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation

IFHA	Investment Fund for Health in Africa
ILO	International Labour Organization
IMF	International Monetary Fund
INFF	integrated national financing framework
IPoA	Istanbul Programme of Action
ITU	International Telecommunication Union
KIS	Kalangala Infrastructure Services
LDC5	Fifth United Nations Conference on the Least Developed Countries
LDC	least developed country
LIC	low-income country
LIFE-AR	LDC Initiative for Effective Adaptation and Resilience
MDB	multilateral development bank
MIGA	Multilateral Investment Guarantee Agency
MSMEs	micro, small and medium-sized enterprises
NDB	national development bank
NDC	nationally determined contributions
ODA	official development assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OOF	other official flows
PIDG	Private Infrastructure Development Group
RDB	regional development bank
SAFIN	Smallholder and Agri-SME Finance and Investment Network
SDG	Sustainable Development Goal
SDR	special drawing right
SDSN	Sustainable Development Solutions Network
SMEs	small and medium-sized enterprises
SPV	special purpose vehicle
THK	Tri Hita Karana
UCLG	World Organization of United Cities and Local Governments
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNCTAD	United Nations Conference on Trade and Development
UN DESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme

UNECA	United Nations Economic Commission for Africa
UNEP FI	United Nations Environment Programme Finance Initiative
UNICEF	United Nations Children's Fund
UN-OHRLLS	United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States
UN Women	United Nations Entity for Gender Equality and the Empowerment of Women
USAID	United States Agency for International Development
WASH	water, sanitation and hygiene
WEF	World Economic Forum
WHO	World Health Organization
WTO	World Trade Organization

Executive summary

This 2020 edition of the UNCDF-OECD *Blended Finance in the Least Developed Countries* (LDCs) report analyses the state of blended finance in LDCs and its role in recovering and building forward better from the COVID-19 crisis. The report also provides a range of expert insights on the opportunities, innovations and risks of deploying blended finance in LDCs, and proposes an Action Agenda to chart a new path to further the mobilisation of support and resources for LDCs. Main takeaways include the following.

LDCs are facing mounting pressure to respond to the COVID-19 pandemic, with widening financing gaps to achieve the Sustainable Development Goals (SDGs). The health crisis is still unfolding in LDCs, at an uncertain yet alarming pace and with a variety of far-reaching implications across countries. What is clear is that all LDCs face severe socio-economic impacts from the global economic crisis, due to domestic and global demand shocks (see Chapters 2 and 3 on the impact of COVID-19 in LDCs).

With development finance accounting for a prominent share of the financing for sustainable development in LDCs, official development assistance (ODA) continues to be a critically important source of finance for these countries. Donor governments are falling short of their commitment on ODA to LDCs, and they should recommit to achieving their targets in light of the unprecedented impact of the COVID-19 pandemic and ensuing economic crisis in LDCs (see Chapter 2 on the state of financing for sustainable development in LDCs).

Although increasing in volume, only 6% of private finance mobilised by development finance interventions between 2012 and 2018 was in LDCs. In 2018 alone, USD 3.8 billion was mobilised in LDCs, accounting for about 7.5% of the total. Multilateral institutions mobilised the largest share of private finance in LDCs (see Chapter 3 on the state of blended finance in LDCs).

Guarantees have continued to be the instruments that mobilised the highest share (46%) of private finance in LDCs in 2017–2018, although to a lesser extent than in previous years. Guarantees were followed by direct investment in companies, and special purpose vehicles, which mobilised 24% of the private finance mobilised in LDCs in 2017–2018.

Private finance mobilised in LDCs is concentrated in a handful of revenue-generating sectors with higher profitability prospects, such as energy, banking and financial services. Sectors such as agriculture and water and sanitation are less targeted, despite their crucial role in LDCs' economies.

While grant support remains critical in the immediate and short-term response to the COVID-19 crisis, blended finance can play a key role to support LDCs in mobilising resources for the medium- to long-term recovery. This will require immediate action to support LDCs to start building a pipeline of bankable projects that both accelerate the achievement of the SDGs and can attract investors' attention. For blended finance to be effective for the COVID-19 recovery, the wide range of actors involved (donors, DFIs, multilateral development banks, impact and commercial investors, local financial institutions, national and local governments, etc.) should focus on supporting national development priorities, including job creation and SME-development, emphasise gender equality, support health systems, and target sectors that are critical for inclusive, resilient and sustainable development.

An Action Agenda to harness the potential of blended finance for the least developed countries

Recognising the complementary roles of public and private finance, the report proposes below four areas of action needed from all stakeholders (see the full Action Agenda in the next chapter). The Action Agenda can help to inform discussions at the Fifth United Nations Conference on the Least Developed Countries (LDC5), to mobilise additional international support measures and action in favour of LDCs.

1. Support domestic financial ecosystems and market development

Blended finance should be used strategically to develop sustainable domestic market systems and build the capacity of local capital market actors, by:

- examining a project's systemic effects on the overall market;
- supporting local capacity-building to improve the enabling environment;
- developing local capital markets, promoting local currency financing solutions and greater mobilisation of local investors;
- strengthening the role of national development banks in deploying blended finance.

2. Design blended finance solutions to reach the "last mile"

Blended finance actors should design innovative structures that target the hardest to reach and most underserved areas, by:

- focusing on risk mitigation tools;
- engaging local stakeholders to identify project opportunities in line with local needs;
- targeting the "missing middle" enterprises;
- employing digital financial solutions;
- ensuring the accessibility and affordability of products and services developed with the support of blended finance investments.

3. Improve impact management and measurement, and promote transparency

Lack of transparency of blended finance operations severely hinders the further growth and improvement of the blended finance market. Blended finance actors should focus on:

- improving impact management and measurement practices;
- increasing the transparency of existing investments;
- promoting collaboration and the sharing of knowledge, best practices and lessons learned.

4. Bring blended finance to large scale through systemic and transformational approaches

Supporting transformation towards more sustainable and resilient economies as LDCs seek to build forward better post-COVID-19 requires blended finance to move towards more systemic approaches, by:

- incorporating blended finance into co-ordinated multilateral crisis responses, national recovery, and sustainable development plans;
- adopting a portfolio approach (through vehicles, platforms) for scalable solutions;

prioritising scalable projects in sectors driving an inclusive, sustainable, green and resilient recovery.

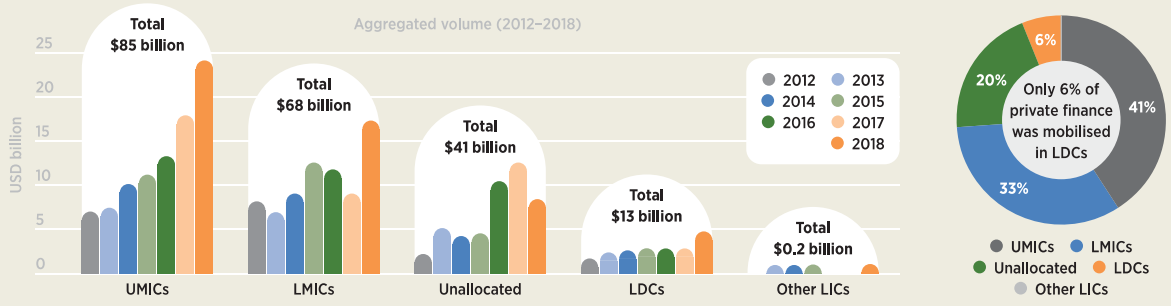
Infographic 1. Key facts on blended finance in LDCs – Part I

Blended Finance in the Least Developed Countries 2020

The least developed countries (LDCs) are the furthest from achieving the Sustainable Development Goals (SDGs). They are also likely to be hit the hardest by the COVID-19 crisis. Blended finance can play a key role to support LDCs in mobilising resources for the medium-to-long term recovery from the COVID-19 crisis.

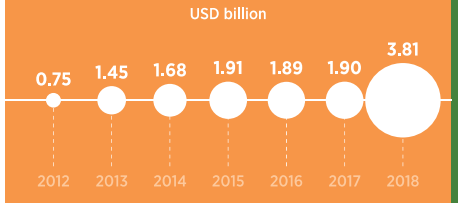
RECENT TRENDS 2012–2018

Private finance mobilised in LDCs, compared to other country groupings



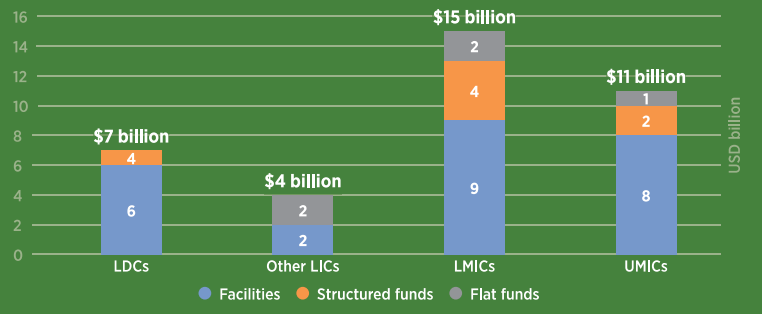
LDCs continue to receive the lowest, although increasing in volume, share of **only 6% of private finance mobilised** by official development finance interventions. Between 2012 and 2018, approximately USD **13.4 billion** was mobilised in LDCs. This compares with over USD 84 billion (41%) in UMICs and USD 68 billion (33%) in LMICs.

Amounts mobilised from the private sector in LDCs: 2012-2018



In 2018 private finance mobilised in LDCs more than doubled compared to the previous year – from USD **1.9 billion** in 2017 to USD **3.8 billion** in 2018.

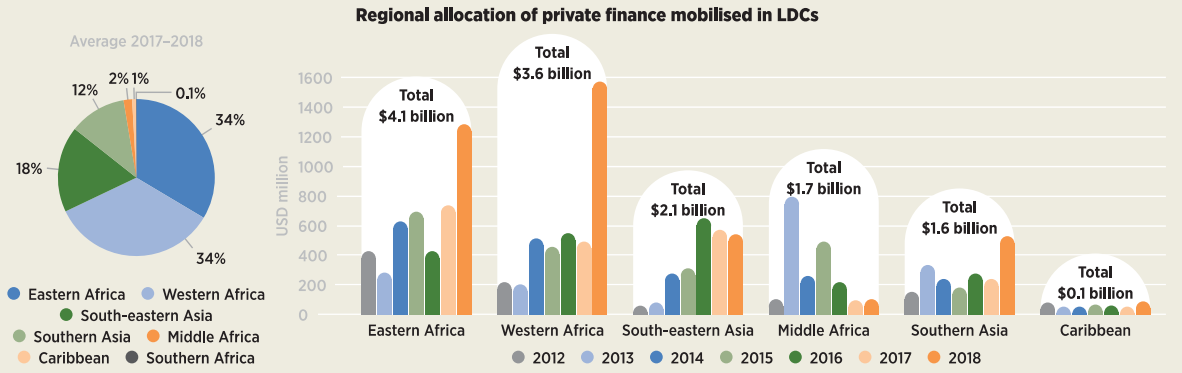
Blended finance funds and facilities: AUM by country grouping (2017)



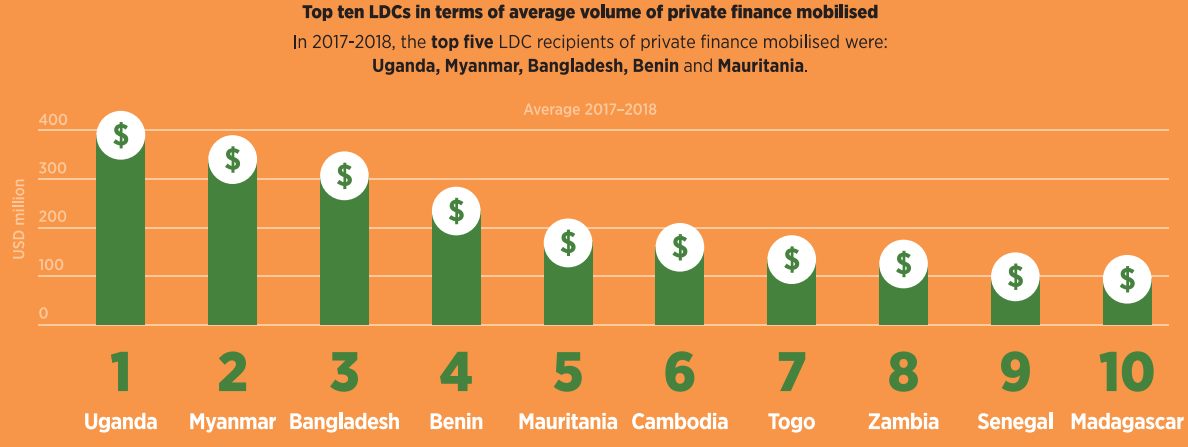
Blended finance CIVs invested USD **7.6 billion** in LDCs (**20%** of USD **38 billion**), of which commercial investors provided only USD **340 million**. More commercial finance was mobilised in structured rather than flat funds, particularly those structured as private equity.

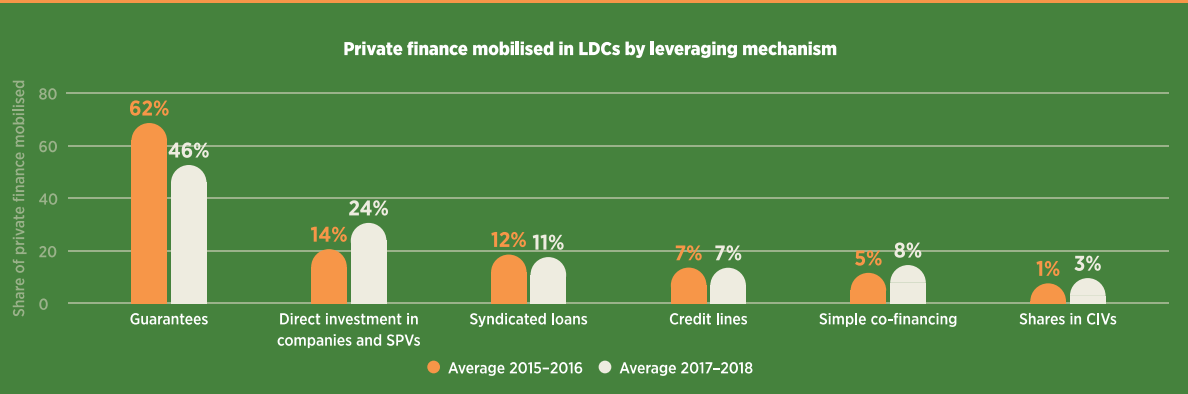
Source: Authors

Infographic 2. Key facts on blended finance in LDCs – Part II



Over the 2012-2018 period, **45 out of the 47** LDCs received private finance mobilised by official development finance at least once. Compared to the 2019 report, **two additional** LDCs - Lesotho and Central African Republic - received private finance mobilised.

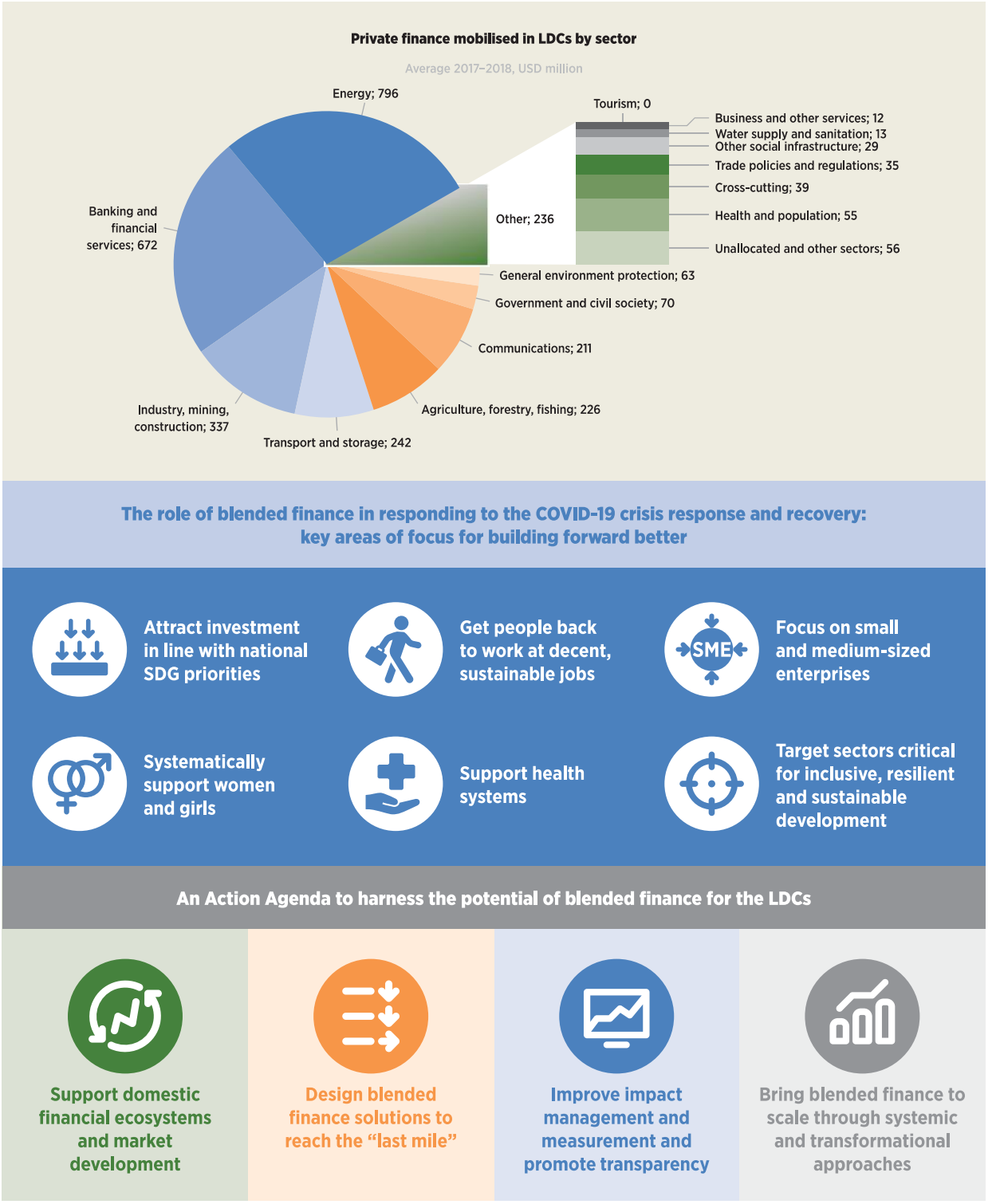




Guarantees mobilised the largest amounts of private finance by official development finance interventions in LDCs, followed by direct investment in companies and SPVs and syndicated loans. Mobilisation through direct investment in companies and SPVs (i.e. equity investments) increased by over **10%** compared to previous years.

Source: Authors

Infographic 3. An Action Agenda to harness the potential of blended finance for the LDCs



Source: Authors

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1. Key findings and Action Agenda

This chapter provides an overview of the main findings and recommendations of the report. It first analyses the challenges that least developed countries (LDCs) faced and progress they made prior to the COVID-19 crisis, as well as how this changed in light of the crisis. The chapter then examines opportunities for deploying and scaling up blended finance in LDCs, specifically in response to the COVID-19 crisis. Finally, the chapter outlines an Action Agenda to harness the potential of blended finance for LDCs.

1.1. The challenges in least developed countries prior to the coronavirus (COVID-19) crisis

Five years into the 2030 Agenda, LDCs are not making sufficient progress on the Sustainable Development Goals (SDGs). While there have been signs of improvement in LDCs – for example, on some indicators on poverty, gender equality and access to safe water and sanitation – LDCs still face major obstacles to eradicating poverty through economic growth, structural transformation, building productive capacity or increasing their share of exports, compared with other developing countries (UN, 2020[1]) (see Annex B). Such obstacles also vary across LDCs, which is a wide group of countries with specific structural vulnerabilities.

Even prior to the COVID-19 crisis, LDCs faced stark challenges in terms of financing for sustainable development. Domestic resource mobilisation is challenging for LDCs, which rely to a large extent (16% of gross domestic product (GDP) in 2018) on external finance, namely development finance, remittances and investment.

Despite increasing interest and efforts to deploy blended finance in LDCs, to date LDCs have not been able to harness the full potential of blended finance to attract private resources. Blended finance is the strategic use of development finance to mobilise commercial finance towards the SDGs, with a focus on unlocking capital that the private sector would not have invested on its own (see Box 1.1) (OECD DAC, 2018[2]). To help meet the significant SDG financing gap in the LDCs, blended finance approaches can use increasingly scarce official development assistance (ODA) resources to mobilise commercial finance at large scale. Most LDCs lack the ecosystem of key actors and enabling policies, structures and capabilities that help to harness the full potential of blended finance (for a discussion on ecosystem development, see the guest contribution in Section 5.6 from Palladium, and Chapter 3 of the 2018 report). Lack of local capital market integration, poor capacity of intermediaries to connect enterprises with funding sources, and a lack of financial structuring knowledge make creating new blended finance vehicles particularly challenging (see the guest contribution in Section 5.9 from GuarantCo on developing local capital markets and local capacity).

1.2. The progress made in blended finance for least developed countries prior to COVID-19

Little progress in mobilising private finance in LDCs has been made since the last edition of this report, with blended finance data exhibiting similar trends (see Chapter 4 on the state of blended finance in LDCs).

LDCs continue to receive the lowest share of private finance mobilised by blended finance. Between 2012 and 2018 about USD 13.4 billion was mobilised in LDCs, only 6% of the total. This compares with over USD 84 billion (41%) in upper-middle-income countries and USD 68 billion (33%) in low- and middle-income countries. In 2018, USD 3.8 billion was mobilised in LDCs, accounting for about 7.5% of the total. While this represents a remarkable increase with respect to previous years, it is mostly driven by changes in data disclosure by some reporting organisations. This underscores the crucial importance of enhancing transparency in the blended finance space and improving data disclosure at a disaggregated level.

Multilateral institutions still mobilise the largest amounts of private finance in LDCs. Bilateral donors tend to mobilise smaller amounts, but are increasingly engaging in blended finance approaches in LDCs. France ranks first and mobilised more than USD 250 million in 2017–2018 in LDCs, followed by the United States, Finland, United Kingdom, Netherlands and Sweden.

Private finance is being mobilised in more LDCs, although with significant heterogeneity across countries. Since the last report, private finance has been mobilised in two additional LDCs (Central African Republic and Lesotho), indicating that between 2012 and 2018, private finance was mobilised in 45 out of

the 47 LDCs. In the same period, five countries received more than USD 1 billion each (Angola, Bangladesh, Myanmar, Senegal and Uganda), while 12 countries received less than USD 10 million, and the remaining 30 countries received USD 270 million on average. In 2017–2018, the top five LDC recipients were Uganda, Myanmar, Bangladesh, Benin and Mauritania.

Guarantees continued to mobilise the largest share of private finance in LDCs (see the guest contribution in Section 5.9 from GuarantCo on the use of guarantees). Direct investment in companies and special purpose vehicles experienced the highest increase in 2017–2018: 24% of the total private finance mobilised and a 10% increase compared with previous years (see the guest contribution in Section 5.3 from Convergence on using funds and facilities to mobilise finance). According to Convergence, most blended finance transactions targeting one or more LDCs benefited from concessional finance within their capital structure. However, the share of this archetype decreased over time (from 75% in 2010–2014 to 60% in 2015–2019) (see Box 4.5 for Convergence's analysis of blended finance archetypes in LDCs).

Energy, and banking and financial services continue to mobilise the largest amounts, with 50% of all private finance mobilised in 2017–2018 concentrated in these sectors (averaging, respectively, USD 796 million and USD 672 million). However, in 2018 compared with 2017, significantly lower shares of private finance were mobilised in the energy, and banking and financial services sectors, as well as in communications. Sectors such as industry, mining and construction (up by 9% in 2018), and transport and storage (up by 3%), but also government and civil society (up by 4%) and health (up by 3%), mobilised a higher proportion of total private finance in 2018 compared with 2017.

Box 1.1. Messages and Action Agenda from the 2018 and 2019 reports

The 2018 *Blended Finance in the Least Developed Countries* report examined the opportunities and challenges for deploying blended finance in LDCs (OECD/UNCDF, 2018[3]). Its sequel in 2019 built on prior analysis to assess progress in and obstacles to expanding the scope of blended finance in LDCs (OECD/UNCDF, 2019[4]). Those reports also laid out a five-point Action Agenda to improve the practice of blended finance while ensuring that its application remains aligned with the goal of attaining the SDGs. It proposed the following.

- Encourage risk taking and experimentation, as appropriate. This remains a necessary priority to the expansion of blended finance in LDC environments with higher real or perceived risks. Key concessional finance providers, including development finance institutions and multilateral development banks, will need to explore ways to innovate and increase risk tolerance to expand efforts to mobilise private finance for LDCs, especially in the unprecedented COVID-19 environment.
- Bring LDCs to the decision-making table. Blended finance actors should engage LDCs in global policy dialogues and processes to make sure blended finance policies and approaches reflect LDC perspectives and respond to the needs in the poorest countries. Further support is also needed to build the capacity of national and local LDC governments and stakeholders on blended finance and related topics.
- Deploy blended finance strategies to support sustainable outcomes. Blended finance approaches and transactions should leverage domestic investors, support the growth of local industry and the development of the private sector and be deployed in tandem with complementary approaches to build local economies and sound enabling environments.
- Improve impact measurement and transparency. Development partners should strengthen ex-ante impact management and measurement of blended finance projects to ensure their SDG-positive impact. To increase transparency, information concerning blended finance transactions and vehicles, such as the amount of ODA used, should be made publicly available.

1.3. The coronavirus (COVID-19) crisis makes the challenges in least developed countries even greater

LDCs face growing uncertainty with evolving development challenges and a widening SDG financing gap. Due to the crisis, the already significant SDG investment gap in LDCs is expected to widen even further.[1] While the impact of the crisis on ODA flows to LDCs is still uncertain, external flows to LDCs (including development finance, foreign direct investment, other, private investment and remittances), which represented on average 16% of GDP in 2018, show signs of being severely impacted. The deteriorating economic situation is likely to lead to declines in domestic resource mobilisation and shrinking fiscal space. As a result, already high debt levels are expected to further increase, as many LDCs will have to increase their borrowing in the absence of other external support (UN, 2020[5]). The COVID-19 crisis has made the prospects for progress even bleaker and is exacerbating existing vulnerabilities and development challenges faced by LDCs (see Chapter 2 on financing sustainable development in LDCs and Annex B on the main gaps between LDCs and other developing countries).

The health and social impacts of COVID-19 are still unfolding in LDCs (see Section 2.3). LDCs' health infrastructure remains under-resourced for COVID-19. Extreme poverty is expected to rise, as the pandemic has created vast unemployment and significant disruptions for the large populations of informal-sector workers. So far, the crisis has had an outsize impact on women and girls, in terms of both employment and access to education. Disruptions in global value chains and food systems, combined with losses in income, have increased food insecurity among the most vulnerable populations.

1.4. Key opportunities for blended finance to tackle the COVID-19 crisis in least developed countries

This report examines the opportunities for deploying and scaling up blended finance in LDCs, specifically in response to the COVID-19 crisis. It builds on the current data and trends observed in LDCs and features guest contributions by practitioners and experts working in the blended finance space. Based on the analysis and insights in the report, the following key opportunities could be leveraged to increase the scope of blended finance activities in LDCs and ultimately support these countries to recover from the COVID-19 crisis and build forward better.

Use blended finance best practices and principles as an anchor to navigate the crisis. To ensure the effective use of blended finance in response to the crisis, blended finance principles and guidance such as those of the OECD Development Assistance Committee (DAC) and the DFI Working Group on Blended Concessional Finance for Private Sector Projects, as well as other agendas, such as the development effectiveness agenda and the Addis Ababa Action Agenda, should be used as an anchor for navigating the crisis (OECD DAC, 2018[2]); (UN, 2015[6]). The DAC has also recently approved the Blended Finance Guidance to support development finance providers in implementing the principles (OECD DAC, 2020[7]). Now more than ever, it will be critical to ensure blended finance programmes have a strong development rationale and deliver impact and results that are monitored and reported in a transparent manner (see the guest contribution in Section 5.11 from Global Affairs Canada on transparency). Blended finance needs to focus on models that optimise the mobilisation of commercial finance while minimising the required concessionality. Blending also needs to target areas and projects where commercial financing is not available, to ensure additionality (see the guest contribution in Section 5.4 from CrossBoundary on additionality) and to avoid crowding out the private sector. Engagement with local beneficiaries is critical to focus blended finance interventions on local priorities and contexts and contribute to local market development and capacity-building (see the guest contribution in Section 5.6 from Palladium on local market development).

Support national recovery plans and development strategies (see Section 3.2.1). In the wake of the crisis, blended finance interventions should seek to align with national development priorities, as articulated in key crisis response plans and national development strategies (see the guest contribution in Section 5.1 from a Member of the Bangladesh Parliament on national ownership). Blended finance should be considered as one of the options to support a country's development priorities, as part of integrated national financing frameworks (INFFs) (see Box 3.3 on INFFs). Tools such as the country private sector diagnostics from the International Finance Corporation (IFC), the SDG investor maps from the United Nations Development Programme (UNDP) and the impact mappings from the United Nations Environment Programme Finance Initiative (UNEP FI) could be useful in identifying local sector and sub-sector priorities and more targeted investment opportunity areas (IFC, 2020[8]); (UNDP, 2020[9]); (UNEP-FI, 2020[10]).

The specific contexts within LDCs, as well as SDG and sector priorities, need to be addressed. For instance, in small island developing states, which rely heavily on oceans-based industries, blended finance efforts could focus on opportunities to scale up or replicate innovative "blue" blended finance schemes, such as blue bonds, debt-for-ocean swaps, blue carbon schemes, insurance schemes to cover oceans-related risks or impact funds for oceans-based activities (OECD, 2020[11]) (see Box 2.6 on blended finance for sustainable ocean economies). Evidence also points to a track record of blended finance instruments deployed in fragile contexts, including for humanitarian purposes. For example, humanitarian impact bonds have been tested, and some private equity funds and impact funds are increasingly operating in fragile contexts (Basile and Neunuebel, 2019[12]) (see Box 4.2 on blending in fragile contexts). Lastly, in contexts such as those of landlocked countries, blended finance could focus on infrastructure, trade and transportation. Beyond sector prioritisation, building greater local capacities is needed to identify and develop pipelines of SDG-aligned, investment-ready projects.

Prioritise sectors that are key to creating decent, productive jobs (see Section 3.2.2). The loss of jobs and livelihoods due to the pandemic risks being more severe than the health impacts. In line with national priorities, blended finance should be prioritised to provide needed capital in LDCs to help protect jobs, sustain the self-employed and support companies' liquidity and operations.

Support small and medium-sized enterprises (SMEs) as engines for growth (see Section 3.2.3). Preliminary findings from a survey on the state of SMEs in LDCs conducted by a consortium of organisations, including UNCDF, show that due to COVID-19, 87.9% of SMEs reported operating on less than 75% business capacity, 34.6% have laid off staff, and 33.9% have indicated that they are at risk of shutting down within three months (UNCDF et al., 2020[13]). SMEs, particularly those in the "missing middle" which are too large for microfinance but considered too small by local banks and development finance institutions (DFIs), will not likely be rescued by government stimulus packages and will struggle to survive the crisis, despite their important role in driving long-term job creation and sustainable economic growth in LDCs. Blended finance vehicles should target this financing gap in LDCs (see the guest contribution in Section 5.10 from UNCDF's LDC Investment Platform team on the "missing middle").

Systematically support women and girls to accelerate the recovery (see Section 3.2.4). Women have been disproportionately affected by the pandemic and continue to face disadvantages, despite widespread recognition of the need for gender equality and of its importance for achieving sustainable development. Blended finance investors should consider targeting women-led enterprises and sectors with high shares of female employment more systematically, including by providing liquidity or working capital to financial institutions and intermediaries that incorporate a gender lens.

Catalyse the growth of health-related industries (see Section 3.2.5). The crisis has demonstrated the need for stronger health systems in LDCs, and many governments have called for investment support to develop domestic industries to produce vital medical supplies and pharmaceuticals. Blended finance could play a catalytic role in that regard, including supporting the dissemination of vaccines.

Target sectors that are critical for inclusive, resilient and sustainable recovery (see Section 3.2.6). Examples include climate-compatible infrastructure, transport and storage, and municipal infrastructure

(see the guest contribution in Section 5.8 from UNCDF's Local Development practice on municipal infrastructure investment). To harness the digital revolution, blended finance could scale up digital infrastructure and digital business models that help to expand access to a wide range of services for currently underserved populations (see the guest contribution in Section 5.7 from UNCDF's Financial Inclusion practice on digital finance). In addition, investments in clean energy and blue economy will help build resilience and enable SDG achievement.

1.5. An Action Agenda to harness the potential of blended finance for least developed countries

This Action Agenda aims to provide concrete steps to harness the potential of blended finance to support LDCs to build forward better from the COVID-19 crisis and make progress on the SDGs. This report and Agenda aim to feed into and help inform the preparatory process for the Fifth United Nations Conference on the Least Developed Countries (LDC5) and the new programme of action for LDCs. The Action Agenda also aims to follow up on the United Nations-supported discussions on financing for development in the era of COVID-19 and beyond, which called for increased efforts to promote private investments in the SDGs in developing countries, including through greater support for innovative blended finance approaches in LDCs (UN, 2020[14]).

The Action Agenda outlined below draws from the research and findings of this report, including views and ideas put forward in the guest contributions. The Agenda builds on recommendations from the previous two reports (see Box 1.1). They seek to respond to some of the key underlying weaknesses and barriers that limit the mobilisation of private finance in LDCs through the use of blended finance approaches, and that concentrate it in few sectors and with limited or unclear development impacts. As such, the Agenda responds to many of the multiple risks and barriers to private investments in the LDCs presented in Box 3.1 and discussed in other parts of this report. The Action Agenda is directed to actors involved in blended finance, including LDC and donor governments, international organisations, domestic and international private sector investors and others providing relevant support for enabling private investments in LDCs.

1. Support domestic financial ecosystems and market development

Blended finance can be used strategically to develop sustainable market systems and build the capacity of local capital market actors.

1.1 Examine a project's systemic effects on the overall market

Blended finance investments should aim to create a new market or strengthen fledgling markets, for example by using concessional finance in the early market development stage, as a temporary intervention to help introduce fully commercial finance over time. First movers' transactions in LDC markets face high initial costs and/or risks, but have a strong potential for market creation, often through demonstration effects and the creation of positive externalities, which then make subsequent transactions easier. Blended finance transactions, particularly those involving concessionality, should be designed to reach commercial sustainability eventually, with clear exit strategies (in line with OECD Blended Finance Principles). Guarantees and risk capital can be effective in creating markets, while concessional debt can be more appropriate in sustaining market growth.

1.2 Support local capacity-building to improve the enabling environment

Blended finance should be implemented in tandem with public reforms and capacity-building to address underlying constraints to private investments. LDCs should design an approach to private investment and blended finance that focuses on building the key components of an ecosystem, including transaction and

business development advisories and conducive legal and regulatory systems. Grant providers can support capacity-building for local investors and public financial institutions. Capacity support should be embedded in the ecosystem to provide local and regional training and facilitate connections among key market actors. Technical assistance should be integrated into blended finance solutions, delivering it pre-investment to increase addressable demand, and continuing it post-investment to reduce risk.

1.3 Develop local capital markets, promoting local currency financing solutions and greater mobilisation of local investors

It is important to accompany blended finance transactions with solutions that support the development of local capital markets to sustain the commercial viability of future investments. Blended finance can also de-risk deals to crowd in domestic capital from local investors to support local governments and SMEs. As an example, concessional local currency solutions, such as guarantees, should be promoted, as they allow the offsetting of asset-liability mismatches at terms that are viable for the project to proceed and/or for the end users to be able to afford to use the products or services (e.g. loans at tenors and terms that are viable for SMEs, but beyond established local capital market rates). Local currency guarantors can support the development of local capital markets and mobilise long-term local currency financing. It is important for foreign donors and investors to manage currency risk through the use of local currency products and/or currency swaps. Furthermore, mobilising local investors such as sovereign wealth funds and local pension funds to provide local currency finance to projects that generate revenues in local currency also contributes to reducing foreign exchange risk, and provides long-term finance (OECD, 2020[15]).

1.4 Strengthen the role of national development banks in deploying blended finance

Enhancing the role of national development banks (NDBs) to support blended finance includes improving governance and ensuring their mandates and business models are fit for purpose to support private sector mobilisation and the use of blended finance approaches. At the country level, governments need to give NDBs clear and stable mandates aligned with the SDGs, ensure they are adequately resourced, and put in place supportive policy and regulatory frameworks. At the international level, multilateral development banks, regional development banks, DFIs and international climate funds need to step up their engagement with NDBs and support the development of their capacity.

2. Design blended finance solutions to reach the "last mile"

LDCs and investors in LDC markets should design innovative blended finance structures, based on country-specific contexts that reach the most vulnerable and underserved communities.

2.1 Focus on risk mitigation tools

In LDCs, there is a need for a targeted and combined use of various financial instruments and mechanisms in blended finance transactions to tackle overlapping layers of risk. This can include higher concessionality, the use of multiple instruments in one transaction, and local currency solutions. Similarly, concessionality levels are likely to be much higher in the last mile than elsewhere. Development partners need to acknowledge this reality and customise blended instruments to local circumstances.

2.2 Engage local stakeholders to identify project opportunities in line with local needs

Development finance providers should engage with local governments and municipalities to identify local investment opportunities where the private sector can provide effective solutions to reach the furthest behind. This will help to unlock finance in LDCs that is targeted to local priorities that have been identified as key to achieving sustainable, green and resilient growth. Beyond local administrations, development partners should also engage with local civil society organisations and micro, small and medium-sized

enterprise associations to identify development challenges to be addressed and possible solutions tailored to local contexts. These actors should also considered when measuring the social and environmental risks of specific projects.

2.3 Target the "missing-middle" enterprises

LDCs and development partners should consider risk-tolerant facilities to support enterprises in the "missing middle", including their customers, suppliers and workers in the poorest and most vulnerable communities, with a systematic focus on women entrepreneurs and SMEs supporting gender equality and women's empowerment. UNCDF's on-balance-sheet lending focuses on "missing middle" investments in LDCs and can help to fill this gap in the development finance architecture.

2.4 Employ digital financial solutions

Digital solutions should be used to reach the last mile, help to bring solutions to large scale, collect data to inform investment decisions and to monitor performance, and mobilise resources from non-traditional sources. Investments to bridge the digital divide will be crucial in bringing these solutions to the last mile.

2.5 Ensure the accessibility and affordability of products and services delivered through blended finance investments

Development partners in blended finance should evaluate the commercial viability of the underlying investment in a blended finance transaction or vehicle and weigh it against the development impacts they want to achieve, including the affordability, accessibility and quality of products and services provided.

3. Improve impact management and measurement and promote transparency

Enhancing impact and transparency is critical to allow for informed decision-making as well as accountability and learning. Often, the development impact of blended finance transactions is unclear because of weak monitoring systems and a lack of transparency.

3.1 Improve impact management and measurement practices

Governments and engaged partners should work to enhance the quality of monitoring and evaluating the sustainable development impact of blended finance investments. In strengthening SDG impact measurement, providers should ensure that ex-ante SDG impact assessments and ex-post evaluations are undertaken and made publicly available. The Tri Hita Karana (THK)[2] working group on impact has developed a practical checklist to assess the impact of blended finance on poor people. It gives a set of questions and screening considerations for the ex-ante assessment of the expected impact, and for the ex-post assessment of the actual impact on poor people, in line with the Global Impact Investing Network's IRIS+ impact metrics (THK Impact Working Group, 2020[16]); (THK and IRIS, 2020[17]). With a better ability to do assessment up front and to measure and track impact, blended finance can be directed towards those projects where the sustainable development impact is greatest. The OECD, in collaboration with UNDP, is currently developing impact standards on financing for sustainable development, focusing on both impact management and measurement.

3.2 Increase the transparency of existing investments

Increased transparency of what is and is not working can serve as a demonstration effect to other potential investors on the realistic investment opportunities and the catalytic effects of blended finance. Finance for future projects can be leveraged by building the evidence base on blended finance projects in LDCs. This includes increasing the availability of data on the financial conditions, risks and development results of

blended finance interventions, as well as more disaggregated and consistent disclosure of the data on the private finance mobilised. Concessional funding providers should request disclosure of this information as part of their financing agreement. The United Nations initiative on financing for development in the era of COVID-19 and beyond also calls for accurate data on all financial flows to ensure transparency (UN, 2020[18]). There have been important efforts to address these issues, such as the IFC's disclosure of the estimated subsidy and justification for each transaction co-funded by blended concessional finance, including through the International Development Association's Private Sector Window. The THK roadmap for blended finance is also working to increase transparency in blended finance (THK Transparency Working Group, 2020[19]).

3.3 Promote collaboration and the sharing of knowledge, best practices and lessons learned

The blended finance ecosystem is composed of a wide range of actors and organisations, with different mandates and incentives. Promoting collaboration and facilitating effective partnering is of crucial importance. This could enhance the sharing of knowledge, best practices and lessons learned from experiences with blended finance in specific contexts or sectors in LDCs. This would contribute to building a track record that would give confidence to donors and investors alike. The recently established OECD DAC Community of Practice on Private Finance for Sustainable Development provides a forum for such dialogue and exchanges between DAC donors and private actors (OECD, 2020[20]). The DFI Working Group on Blended Concessional Finance for Private Sector Projects and its joint reports, published annually since 2017, are good efforts in this spirit.

4. Bring blended finance to large scale through systemic and transformational approaches

Efforts to build forward better post-COVID-19 should be designed not just to help countries bounce back to pre-crisis status, but rather to support a transformation to more resilient and sustainable economies that can drive SDG progress. This means doing more than restarting economies and restoring livelihoods to their pre-crisis levels. For blended finance to make a difference and have sustained relevance in LDCs, it must be used to respond in a systemic way to systemic crises.

4.1 Incorporate blended finance into co-ordinated multilateral crisis response and national recovery plans

Blended finance should be explicitly included in the global agenda as the development community shapes the crisis response for LDCs. This would entail exploring how public stimulus packages and other donor efforts to respond to the crisis, including debt relief measures, can be used more explicitly to leverage additional SDG-positive private investments. This can be done by using analytical tools such as the integrated national financing frameworks and nationally determined contributions, SDG investor maps and IFC country private sector diagnostic to identify priority sectors for blended finance investment.

4.2 Adopt a portfolio approach (through vehicles, platforms) for scalable solutions

A deal-by-deal approach to recovery will not reach the scale or transformational change needed to address the new risks posed by COVID-19 and advance the fight against existing vulnerabilities exacerbated by the pandemic. Development funders should prioritise a portfolio approach along with asymmetrical risk-return profiles to mobilise private investors. This includes the greater use of collective or pooled investment vehicles (funds and facilities) and special purpose vehicles with different tranches, in addition to guarantees, to better manage risks and achieve greater mobilisation of private sector finance. Mobilising private investment at large scale by increasing the ticket/deal size, such as through the aggregation of

multiple projects, across multiple LDCs, projects and/or sectors, creates diversification to reduce risk-return variance for investors. Enhanced collaboration and co-ordination are needed among blended finance actors, for example to capitalise, replicate or create structures to scale up blended finance, with specific focus or targets on LDCs.

4.3 Prioritise scalable projects in sectors driving an inclusive, sustainable, green and resilient recovery

To support LDCs to recover from COVID-19 and rebuild better, blended finance actors will need to ensure that investments contribute to an inclusive, sustainable and resilient system. Post-COVID-19 blended finance arrangements will, therefore, need to prioritise investments that promote job creation and strengthen sectors that can drive and balance economic growth, environmental sustainability, well-being and inclusiveness. Blended finance should focus on catalytic interventions that can demonstrate the viability of new business models and economic sectors with the aim of unlocking larger commercial investments in such areas. This means that blended finance investments, irrespective of sector focus, could focus on:

- targeting strategic opportunities that could result in the significant creation of decent jobs;
- integrating digital solutions to enhance access and reduce risk and transaction costs;
- supporting women's economic empowerment and gender equality;
- aligning with long-term emissions reduction goals and factoring in resilience to climate impacts;
- slowing biodiversity loss and increasing circular economy approaches.

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Notes

[1] The financing gap to achieve the SDGs in developing countries was estimated at USD 2.5 trillion annually before the pandemic. Current estimates indicate that, considering the increase in needs and drop in resources due to the COVID 19 crisis, the SDG financing gap could increase by USD 1.7 trillion – that is, by about 70% in 2020 (OECD, 2020[22]).

[2] Established in Bali, Indonesia, in October 2018, the THK Roadmap for Blended Finance is a unique platform for international dialogue on blended finance. It brings together stakeholders from all over the world, including donor agencies, development finance institutions, multilateral development banks, civil society organisations, philanthropic foundations, private sector stakeholders, and impact investment communities (THK, 2018[21]).

2. Financing sustainable development in least developed countries

COVID-19 is having significant health and socio-economic impacts in least developed countries (LDCs) and is expected to cause major setbacks in these countries' already limited progress in achieving the Sustainable Development Goals (SDGs). This chapter provides an overview of the key financing challenges faced by LDCs, and outlines the economic and social impacts of and responses to COVID-19 in LDCs.

2.1. Least developed countries continue to face stark challenges across development and well-being dimensions

The United Nations defines LDCs as "low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets" (see Annex A for an overview of the criteria for the inclusion and graduation of LDCs) (UN/DESA, 2020[1])**.** There are 47 countries on the list of LDCs.[1] They are home to 1.03 billion people, about 14% of the world population, but with a combined GDP accounting for less than 1.3% of total global GDP (World Bank, 2019[2]).

The Istanbul Programme of Action (IPoA) for the LDCs, resulting from the Fourth United Nations Conference on the Least Developed Countries (LDC-IV), laid out the international community's strategy and vision to overcome the structural challenges faced by the LDCs for the 2011–2020 decade (UN, 2011[3])**.** The 2020 ministerial declaration of the LDCs calls for more blended finance to mobilise additional resources in LDCs (UN-OHRLLS, 2020[4]). The next Programme of Action is expected to result from the Fifth United Nations Conference on the Least Developed Countries (LDC5), scheduled for January 2022 in Doha. The 2030 Agenda recognised LDCs' specific challenges and vulnerabilities and set a number of LDC-specific targets, such as achieving at least 7% GDP growth per annum (SDG target 8.1) (UN, 2015[5]).

In the final year of the IPoA, evidence shows that despite significant progress in certain areas, LDCs still face structural impediments to eradicating poverty through economic growth, structural transformation, building productive capacity or increasing their share of exports (UN, 2020[6])**.** Most LDCs still experience significantly lower growth than the targets in the IPoA, well below the levels needed to eradicate extreme poverty by 2030. Beyond growth, the latest available data show significant differences between LDCs and other low-income countries across several human, social development, and economic and environmental sustainability dimensions. (See Annex B for an overview of the main gaps between LDCs and other developing countries.) Moreover, LDCs have been severely hit by the COVID-19 pandemic and the ensuing global economic downturn, exacerbating already existing vulnerabilities, as outlined in Sections 2.2 and 2.3.

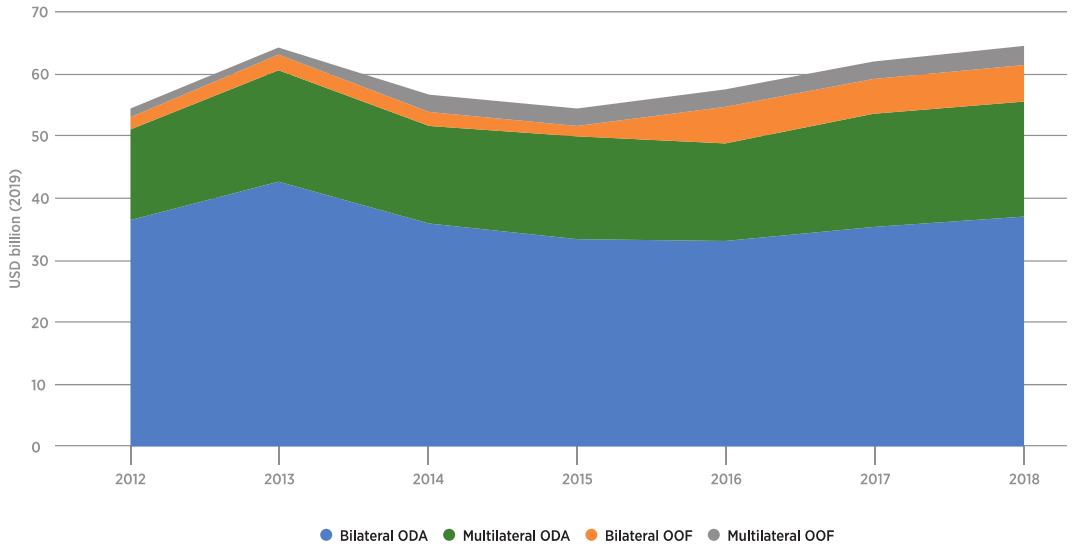
2.2. Least developed countries faced severe SDG financing gaps even before the coronavirus (COVID-19) crisis

Although SDG financing challenges are common to all developing countries, LDCs face particular barriers. Financing investment through domestic resources is challenging for LDCs, which have low levels of income and domestic savings and often ineffective domestic resource mobilisation. Although tax revenues represent on average the largest source of financing for sustainable development in developing countries, they account for a much lower share of GDP in LDCs – 14.2% here, compared with 19.2% in low- to middle-income countries and 21.7% in upper-middle-income countries, as Figure B.1 in Annex B shows. LDCs rely to a large extent on external finance (i.e. development finance, remittances, and foreign direct investment (FDI), private investment and other investment – each having specific financing purposes), which represents a larger share of LDCs' GDP (16%) than domestic finance (14%).

Development finance is a critically important source of financing for LDCs. Looking specifically at official development finance trends, Figure 2.1 below shows that overall development finance to LDCs has been on an upward trend since 2015, with bilateral development finance largely exceeding multilateral. Official development assistance (ODA), which is provided on concessional terms,[2] largely dominates the official development finance landscape in LDCs. Preliminary data for 2019 suggest that, on a cash flow basis, net bilateral ODA flows to LDCs increased by 2.6% in real terms (OECD, 2020[7]). However, ODA

provided to LDCs by DAC donors accounted for only 0.09% of the gross national income (GNI) of donor countries in 2018, well below their 0.15–0.20% ODA-to-GNI commitment[3] (see Annex B for details).

Figure 2.1. Official development finance to LDCs



Note: ODA: official development assistance; OOF: other official flows
Source: Authors, building on data collected for (OECD, 2020[7]), *Global Outlook on Financing for Sustainable Development*, https://dx.doi.org/10.1787/e3c30a9a-en.

Development finance providers should increase efforts to maintain ODA budgets and keep external financing flowing, including private investment and remittances, especially in LDCs (OECD, 2020[7]). In April 2020, DAC members issued a statement, committing to "strive to protect ODA budgets" (OECD DAC, 2020[8]).

DAC donors have also been increasingly leveraging scarce development finance resources to mobilise additional private finance for sustainable development in LDCs, through blended finance approaches. Chapter 4 provides a detailed overview on the latest trends of private finance mobilised in LDCs, building on OECD data. At the high-level meeting in November 2020, DAC members acknowledged the importance of ODA to respond to the COVID-19 crisis and promote long-term sustainable development, especially in LDCs. They also pledged to "continue working to find ways to mobilise more official and private resources for sustainable development, including promoting more – and more effective – blended finance, with special attention to LDCs" (OECD DAC, 2020[9]). It will be of utmost importance that DAC members implement these commitments.

2.3. Impacts of and responses to coronavirus (COVID-19) in least developed countries

Significant socio-economic impacts of the pandemic risk reversing the progress made in achieving the SDGs in LDCs. LDCs would have been better equipped to face and recover from the COVID-19 crisis had they been further advanced in meeting the SDGs and the Paris Agreement by the time of the crisis, including with stronger health systems, more resilient infrastructure and diverse economies, more gender equality, and better access to energy and digital services. Instead, the significant impacts of the pandemic now risk reversing any progress made in achieving the SDGs in LDCs.

2.3.1. COVID-19 health impacts are unfolding in LDCs at an uncertain yet alarming pace

While the spread of the coronavirus had a slow start in LDCs, it has accelerated, with a high incidence of imported cases (Bhattacharya and Islam, 2020[10])**.** LDCs had about 2.1% of the total global recorded cases and 1.3% of global recorded deaths as of October 2020 (EAPD/UNDESA, 2020[11]). However, there are concerns about serious under-reporting of cases and fatalities, due in part to the weak health systems and low testing capacities of LDCs (UN/DESA, 2020[12]).

While LDCs' young populations might be considered an advantage against the COVID-19 pandemic, **people in LDCs often have limited access to healthcare and lack basic water and sanitation facilities**, which are essential for hand hygiene and critical to preventing the spread of the virus (Bhattacharya and Islam, 2020[10]); (WHO, 2020[13]). COVID-19 is also hitting countries that are recovering from other epidemics, such as Ebola in West Africa (UN/OHRLLS, 2020[14]). Further, COVID-19 is likely to disrupt the delivery of other health services and the uptake of immunisation, especially in LDCs (UNICEF, 2020[15]).

Among LDCs, the extent of the health impact of the pandemic varies greatly. Bangladesh, the most populated LDC, has the highest number of reported cases. Moreover, while small island developing states reported a limited number of infections (due to their geographical remoteness), some LDCs with conflict or post-conflict status reported high numbers of confirmed cases. Further, overpopulated slums and refugee camps in LDCs are at high risk of uncontrollable COVID-19 outbreaks (Bhattacharya and Islam, 2020[10]).

2.3.2. The COVID-19 crisis is taking a heavy toll on LDCs' economies

The socio-economic impacts of COVID-19 in LDCs have been significant and risk reversing years of hard-won progress on sustainable development. Rapid and aggressive lockdown measures in most LDCs, including workplace closures, school closures and stay-at-home orders, have significantly reduced domestic demand and have forced businesses to shut down or to reduce operations. The real GDP growth rate for LDCs in 2020 is expected to plummet to 0.8%, down from 4.5% in 2018 and 4.8% in 2019 (UN, 2020[16]). The economic recovery is projected to be even slower than previously forecast (IMF, 2020[17]).

In addition to reduced domestic demand, the economic impact on LDCs is due in large part to the drastic contraction in global economic activity. Declining global demand, along with supply chain disruptions, is affecting LDCs' exports, particularly in textiles and garments. Disruptions in the tourism sector are heavily impacting small island LDCs. Many LDCs are also highly dependent on the natural resources sector (e.g. Angola's economy is heavily dependent on oil exports, Zambia's on copper exports), which is being negatively affected by a collapse in oil and commodity prices (UN-OHRLLS, 2020[18]).

The outlook for flows of FDI into LDCs in 2020 and beyond is also very weak. Globally, a drop in FDI by up to 40% is expected for 2020 (UNCTAD, 2020[19]). About a third of the total FDI investment in LDCs went to extractive industries, and, with sharply lower commodity prices caused by COVID-19, new FDI in the sector can be expected to be put on hold. FDI in other negatively affected export sectors such as tourism and textiles is also expected to suffer in the near to medium-term (UNCTAD, 2020[20]).

Flows of remittances, an important source of external finance for many LDCs, have dried up significantly as migrant workers from LDCs lose their jobs and return from host countries affected by the pandemic. While LDC-specific data are not yet available, projections indicate that remittances to sub-Saharan Africa and South Asia will fall by 23.1% and 22.1% respectively in 2020 as a result of COVID-19 (World Bank, 2020[21]).

In the short term, ODA will be critical to leverage additional finance in response to the crisis (OECD, 2020[22])**.** ODA has proven to be a key resource and countercyclical flow in past crises (OECD, 2020[23]). Given the unprecedented shock of the COVID-19 crisis, particularly in LDCs and fragile countries, ODA is

likely to play an even more important role to prevent a rapid increase in extreme poverty and a reversal of the SDG progress in LDCs. Yet the global economic recession and declining public revenues risk putting downward pressure on ODA levels. Ultimately, how official development finance will evolve is still uncertain, and this remains a question of political will and global solidarity. As many ODA budgets for 2020 and 2021 had been finalised before the outbreak, the effect of the global economic recession on ODA levels might not be immediate but might show up later as a lagging indicator.

The COVID-19 crisis is further exacerbating the already high debt burden of LDCs. According to the World Bank Group-International Monetary Fund (IMF) debt sustainability framework, six LDCs were classified as debt distressed, with an additional one in external debt distress, and 16 LDCs faced a high risk of debt distress[4] (World Bank and IMF, 2020[24]). The composition of the debt stock of LDCs also changed significantly in the last decade, with an increasing share of debt held by private and non-traditional bilateral creditors (notably China). This is likely to pose challenges to creditor co-ordination (UN, 2020[6]). To rebuild their economies and mitigate social impacts, these countries will now have to increase their borrowing in the absence of other external support, as their already limited fiscal space will narrow further due to the crisis. While debt suspension efforts such as the debt service suspension initiative (DSSI), in which 29 LDCs participate,[5] are helpful in the short- to medium-term to address liquidity constraints, debt cancellation may be needed for the most vulnerable, highly indebted countries to avoid widespread defaults and to facilitate investments in recovery and the SDGs.

2.3.3. Other social impacts in LDCs due to COVID-19

The pandemic and ensuing crisis have created vast unemployment. In the second quarter of 2020, low-income countries registered a decline of 11% in the number of working hours, representing a 10.1% loss of labour income, in line with the global average of 10.7% loss of labour income (ILO, 2020[25]). In Bangladesh, for example, where garment manufacturing is the largest sector of employment, the workforce has been significantly affected as global demand has fallen and billions of dollars' worth of retail orders have been cancelled (Akiwumi, 2020[26]). The challenge of getting people back to work will be particularly difficult in LDCs, where high shares of the populations are self-employed and excluded from efforts to support the formal economy. Microfinance and support for financial intermediaries will remain important to reach informal workers. Moreover, many LDCs lack social protection systems to assist workers during times of crisis (UN/DESA, 2020[12]). More importantly, in low-income countries, the stimulus gap amounts to less than 1% of the total value of the above-the-line fiscal stimulus measures announced by high-income countries (ILO, 2020[25]). Support for the private sector will be essential not only to reduce job losses and preserve livelihoods but also to create new, high-quality and resilient jobs (EDFI, 2020[27]).

The crisis is having a disproportionately negative impact on women and girls, especially in fragile and conflict-affected contexts (OECD, 2020[28])**.** Girls and young women stand to be particularly affected by extreme poverty due to the COVID-19 crisis, according to the estimation of the United Nations Development Programme (UNDP) and the United Nations Entity for Gender Equality and the Empowerment of Women (UN Women) (Azcona, Bhatt and Kapto, 2020[29]). While sub-Saharan Africa is expected to continue being where most poor women live, Central and South Asia is expected to experience a resurgence in women's extreme poverty due to the pandemic (ibid.). There are signs that women are suffering increasingly from gender-based violence as a result of lockdowns and confinements, and that resources are being diverted from women's healthcare. Furthermore, there are indications that the pandemic will have long-term negative impacts on both women's employment and girls' participation in education (UN, 2020[30]).

Food insecurity is on the rise. The impact of the crisis on food systems, in combination with the effects of lost incomes, is pushing the world's poorest and most vulnerable people towards greater food insecurity. Globally, 135 million people faced acute food insecurity before COVID-19, and that number is expected to

double to 270 million people in 2020, affecting poor and vulnerable people disproportionately (UN News, 2020[31]). Some 28% of the world's undernourished people live in LDCs (UN-OHRLLS, 2020[4]).

2.3.4. The responses, both domestic and international, in LDCs have been limited

To respond to the COVID-19 crisis, the United Nations Secretary-General has called for a global stimulus package that is a double-digit percentage of global GDP (UN, 2020[32]). The United Nations General Assembly also passed a resolution that called for a "comprehensive and co-ordinated response" to the pandemic. However, to date, there has been little appetite among the leading economies for a co-ordinated effort to support socio-economic stimulus in the LDCs. While the World Health Organization emergency appeal has been 93% funded at USD 1.6 billion, the humanitarian response plan of the United Nations Office for the Coordination of Humanitarian Affairs has been only 33% funded at USD 3.3 billion, of which some USD 1.45 billion is targeted specifically at 24 LDCs (UN Info, 2020[33]). The United Nations COVID-19 response and recovery fund has mobilised significantly less than anticipated.

The United Nations development system is working together to assess the socio-economic impacts of the COVID-19 pandemic on economies and communities, and has produced socio-economic impact assessments for some 33 of the 47 LDCs. It is also preparing response plans that include estimates of the investment needed (UNDP, 2020[34]). The United Nations development system repurposed some USD 2.9 billion of existing programming resources to support countries to respond to the crisis, of which an estimated USD 719 million was used across 33 of the LDCs (UN Info, 2020[33]).

The World Bank Group and the IMF have taken quick but relatively limited action. The IMF has an overall lending capacity of USD 1 trillion, but in response to the crisis it has so far lent only USD 280 billion, with USD 11 billion going to low-income countries (Goodman, 2020[35]). The International Development Association and the International Bank for Reconstruction and Development (IBRD) have, in the first seven months of 2020, increased total lending by 118% compared with the same period in 2019, although disbursements of funds are up only 31%. Compared with the global financial crisis in 2008–2009, this is less than half of the increase in monthly disbursements then (Duggan et al., 2020[36]). In low-income countries, loan disbursements have increased only slightly compared with last year, by about 0.33% of 2018 GDP. While this is a somewhat larger increase than low-income countries saw during the global financial crisis, the current crisis is significantly more severe for the poorest countries (ibid.). In March 2020, the International Finance Corporation designed a USD 8 billion fast-tracking financing response to provide immediate liquidity to its financial institutions and real sector clients to preserve jobs and prevent short-term damage. As of the end of October 2020, USD 4 billion had been committed under this first emergency response, of which close to half was expected to benefit people in the poorest countries and fragile states (IFC, 2020[37]). Furthermore, the World Bank Group is not participating in the G20 debt service suspension initiative, which offers, on request, the suspension of loan principal and interest payments from all official bilateral creditors to 73 low- and lower middle-income countries (Duggan et al., 2020[36]).

Several experts have also advocated that the IMF's special drawing rights (SDRs)[6] allocation be targeted to developing countries to support them to overcome liquidity shortfalls stemming from the COVID-19 crisis (Gallagher, Ocampo and Volz, 2020[38]); (Griffiths, 2020[39]); (Plant, 2020[40]); (ODI, 2020[41]); (UNCTAD, 2020[42]); (UN, 2020[43]). SDRs could be exchanged for hard currency for developing countries to bridge balance-of-payments financing gaps. However, SDRs can be allocated in proportion to members countries' IMF quotas, which are low for LDCs. The United Nations Conference on Trade and Development (UNCTAD) proposed that a new SDR allocation should go mostly or exclusively to developing countries (UNCTAD, 2020[44]). In March 2020, the IMF reported that it was considering the option of an SDR allocation to low- and middle-income countries with its members (IMF, 2020[45]). A USD 50 billion liquidity and sustainability facility for Africa has also been proposed by the United Nations Economic Commission for Africa (UNECA) and others, to lower borrowing costs by ensuring that short-term debt obligations can be met (UNECA, 2020[46]).

Finally, on 28 May 2020, **Canada, Jamaica and the United Nations Secretary-General convened a high-level event to join forces with heads of state and government, international organisations and other key partners to enable leaders to take the ambitious responses needed to address the COVID-19 pandemic.** As a follow-up to the event, a menu of policy options was prepared by six discussion groups convened to address questions of external finance and remittances; jobs and inclusive growth; recovering better for sustainability; global liquidity and financial stability; debt vulnerability; the engagement of private sector creditors; and illicit financial flows (UN, 2020[47]).

Domestically, the response to the crisis from most LDC governments has been limited and nowhere near the level of the unprecedented rescue packages provided in high-income economies. The average fiscal stimulus in low-income countries is estimated at 1% of GDP, according to the IMF (IMF, 2020[48]). Most LDC governments have provided some income or food support, though this is limited due to lack of social protection systems (UN/DESA, 2020[12]). Many LDCs have also developed support programmes that provide loans, guarantees or tax relief for affected firms, and income to workers. These measures, however, often fail to reach people in the informal economy, who are also the most vulnerable (ibid.). Some LDCs are providing relief by reducing transaction fees or increasing balance and transaction limits for mobile money payments and other digital financial services (ibid.). In addition, several LDCs are accelerating the implementation of e-government services online to keep procedures such as business registration available, to mitigate the impact on business and investors (UNCTAD, 2020[20]). Initial findings indicate that small and medium-sized enterprises (SMEs) in LDCs that were provided with some form of government support have stronger positive revenue outlooks and better operational capacity than those that were not supported. However, more than half of the SMEs surveyed indicated that they had not received any support (UNCDF et al., 2020[49]).

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World Bank and IMF (2020), *Debt Sustainability Analysis (DSA)*, https://www.worldbank.org/en/programs/debt-toolkit/dsa (accessed on 25 June 2020). [24]

Notes

[1] The 47 countries classified by the United Nations as LDCs are: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Djibouti, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, the Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, the Sudan, Timor-Leste, Togo, Tuvalu, Uganda, the United Republic of Tanzania, Vanuatu, Yemen and Zambia. For more information, see http://unohrlls.org/about-ldcs.

[2] ODA mostly includes grant payments and, to a lesser extent, concessional loans (with a grant element of at least 25%), with the primary objective to promote economic development and welfare in recipient countries.

[3] LDCs have exclusive access to international support measures, including for development co-operation. Donors made a long-standing commitment to provide the equivalent of 0.15% to 0.20% of their GNI in the form of ODA to LDCs, reiterated in the Addis Ababa Action Agenda and included in SDG target 17.2 (more information is at https://www.un.org/ldcportal/commitments-regarding-oda-to-ldcs).

[4] The six LDCs in debt distress (overall and external debt) are Mozambique, Sao Tome and Principe, Somalia, South Sudan, the Sudan and Zimbabwe. The 16 LDCs in high risk of debt distress (overall and external debt) are Afghanistan, the Central African Republic, Chad, Djibouti, Ethiopia, the Gambia, Haiti, Kiribati, the Lao People's Democratic Republic, Liberia, Malawi, Mauritania, Sierra Leone, Togo, Tuvalu and Zambia (as of November 2020).

[5] As of November 2020 (World Bank, 2020[50]).

[6] The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. So far SDR 204.2 billion (equivalent to about USD 281 billion) have been

allocated to members, including SDR 182.6 billion allocated in 2009 in the wake of the global financial crisis. https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR

3. The role of blended finance in the coronavirus (COVID-19) crisis response and recovery in least developed countries

Blended finance approaches could mobilise some of the significant investments needed to build more sustainable, diverse and dynamic economies and societies in least developed countries that can withstand future crises and drive Sustainable Development Goal (SDG) achievement. This chapter explores the different roles blended finance can play in the short- and medium-term responses to COVID-19, as well as against the key risks associated with least developed countries (LDCs) that are emphasised by the crisis. This chapter also outlines key priority sectors where blended finance could be strategically deployed to catalyse investments that will help to accelerate a resilient COVID-19 recovery and progress on the SDGs.

3.1. The role of blended finance in responding to the coronavirus (COVID-19) crisis: a phased approach

3.1.1. Immediate and short-term response

Private sector mobilisation remains particularly challenging in the immediate response given the high risks in LDCs. The magnitude of the COVID-19 shock is unprecedented, and there is still uncertainty about how the pandemic and response will evolve in LDCs. As a result, during this initial phase, record levels of capital outflow have been noted. The focus of international co-operation has been mainly on grant support, with the aim of responding to the heath emergency and protecting the most vulnerable populations by providing safety nets. In 2018, 90% of official development assistance (ODA) to LDCs came in the form of grants, a drop from about 93% in 2015 (UN, 2020[1]). While this decline was most notable in certain economic sectors, it will be important for ODA providers to avoid further diverting important grant funding from key social sectors in LDCs. Moreover, many donor governments are falling short on their ODA commitments and should strive to achieve their targets, considering the unprecedented crisis. By design, blended finance may have more of a role in the medium- to long-term recovery. To remain on track to achieve long-term development goals, some ODA resources can be used to mobilise private sector resources to finance the COVID-19 economic recovery, using effective partnering strategies in line with the Kampala Principles (GPEDC, 2019[2]).

In the short term, the focus has been mainly on protecting broader development finance portfolios, rather than launching COVID-19 blended finance vehicles. Development finance providers have mostly focused on protecting existing investments, safeguarding their portfolios and preserving jobs. The general risk aversion of development finance institutions (DFIs) makes it particularly challenging for them to attract even more risk-averse commercial investors in LDCs and find new investable opportunities in the near term and as long as the pandemic is ongoing. The travel restrictions in place in LDCs make it challenging to conduct due diligence processes for DFIs investors, requiring deeper local partnerships with financial institutions (THK, 2020[3]) At this stage, DFIs are mainly focusing on countering the liquidity shortages of their clients and restructuring loans or simplifying procedures to implement fast-track investment processes and to disburse quickly. While many DFIs appear to have acted urgently by making announcements in terms of financial commitments, it is difficult to assess whether these are related to a reallocation of existing funding to address the COVID-19 emergency, or new commitments from additional funding. Germany's development bank KfW provides a good illustration of the opportunity for DFIs to open new facilities. With investment manager Incofin and Germany's Federal Ministry for Economic Cooperation and Development (BMZ), KfW has launched the agri-finance liquidity facility, an emergency liquidity facility to give smallholder farmers in developing countries an opportunity to maintain their operations during and after the COVID-19 crisis (Incofin, 2020[4]). Other new initiatives include the three-year, USD 3 billion Fight COVID-19 Social Bond issued by the African Development Bank, the largest dollar-denominated social bond launched in the international capital markets to date (African Development Bank, 2020[5]), and the additional funding from the International Finance Corporation (IFC) for low-income countries and LDCs through its real sector crisis response and its working capital solutions initiatives supported by concessional resources provided by the International Development Association (IDA) Private Sector Window (see the guest contribution in Section 5.2 from the IFC).

Similar to DFIs, impact investors are also prioritising the need to address their portfolio companies' solvency constraints in the short term, while also launching some new blended finance initiatives. The Response, Recovery and Resilience Investment (R3) Coalition launched in May 2020 aims to identify and fill financing gaps and quickly deploy impact capital to investment opportunities responding to the current COVID-19 crisis. The Coalition's August 2020 report highlights efforts made by impact investors to protect their current investees, including by providing liquidity infusions directly, often via working capital

or bridge financing (GIIN, 2020[6]). The short-term focus is therefore on responding to immediate needs and strengthening investee resilience through this emergency and any future crises (ibid.).

Blended finance has been used to support trade finance to ensure that market access channels remain open in the short term. The pandemic and resulting global supply chain disruptions are posing risks to African trade in the form of falling export revenues, limited access to foreign exchange liquidity and a risk of decreased supply of bank-intermediated trade finance (Nyantakyi and Drammeh, 2020[7]). As a result, it is critical to extend the capacity of local banks in LDCs to deliver trade financing by providing risk mitigation tools in challenging markets where credit lines may be constrained. For example, the global trade finance programme (GTFP) developed by the IFC offers local banks partial or full guarantees covering payment risk for trade-related transactions. Through the GTFP bank network, local financial institutions work with international banks that can broaden access to finance and reduce cash collateral requirements (IFC, 2020[8]). In response to COVID-19, up to USD 400 million of concessional IDA Private Sector Window resources have been made available to low-income countries and fragile states to ensure continued availability of trade finance.

A relatively small number of LDCs have provided relief measures for small and medium-sized enterprises (SMEs) to weather the crisis. Eleven LDCs report having put in place or expanded guarantee mechanisms to extend access to credit for SMEs (IMF, 2020[9]). For example, Cambodia has provided a USD 200 million credit guarantee fund. Lesotho, Mali, Niger and Senegal have also announced SME guarantee funds. New initiatives have also been taken by microfinance institutions to support the informal sector in developing countries. In April 2020, a group of fund managers (BlueOrchard, Developing World Markets, Incofin, MicroVest, Oikocredit, responsAbility, Symbiotics, Triodos and Triple Jump) issued a memorandum of understanding to co-ordinate their response to support microfinance institutions in response to the COVID-19 crisis (European Microfinance Platform, 2020[10]).

Beyond such initiatives, new ideas and proposals on harnessing blended finance approaches for the COVID-19 recovery are emerging. There are calls to create a global health security challenge fund to blend resources from national governments, global financial institutions such as the World Bank, bilateral development agencies, international philanthropies and the private sector to help at-risk economies to improve their preparedness for epidemic scenarios (Convergence, 2020[11]). The United Nations-supported initiative on financing for development in the era of COVID-19 and beyond calls for increased efforts to promote private investments towards the SDGs in developing countries, including through greater support for innovative blended finance approaches in LDCs (UN, 2020[12]). In addition, the 30 financial institutions in the Global Investors for Sustainable Development Alliance (GISD), convened by the United Nations Secretary-General, has called for the establishment of a blended finance fund for the SDGs, modelled after the IFC's managed co-lending portfolio programme. The aim of this fund would be to aggregate projects that were not previously bankable to take blended finance to large scale (GISD Alliance, 2020[13]).

3.1.2. Medium- to long-term response

Blended finance can play an important role in the medium- to long-term response to the pandemic, in two ways. First, it can stimulate economic recovery and, second, improve resilience for future crises, from both financial and sustainability standpoints.

Private finance mobilisation remains central but challenging in the medium-term, given the high risks in LDCs. Even prior to the crisis, OECD data show that only 6% of the private finance mobilised by official development finance interventions in 2012–2018 went to LDCs (OECD DAC, 2020[14]). Concessional finance providers will need to think critically about how best to use their scarce resources and get the balance right between leverage and development impact (see the guest contribution in Section 5.4 from CrossBoundary on how to evaluate this choice). Blended finance practitioners will need to make a stronger case for the role of blending in building resilient and sustainable market systems to help build forward better in countries that are being left behind. To take blended finance to large scale and achieve

greater impact in LDCs post-COVID-19, wider engagement of philanthropists and new investors, along with joined approaches between grant and non-grant providers, will be needed (see the guest contribution in Section 5.5 from ThinkAhead Consulting).

Meeting the significant sustainable investment needs in LDCs post-COVID-19 will require thinking more strategically about how blended finance can be deployed at large scale. Overall, this could mean moving away from a focus on individual transactions towards greater use of blended finance funds and facilities. For example, the small size of individual investment projects in LDCs is one acute barrier that prevents the mobilisation of private finance. As argued in the guest contribution in Section 5.3 from Convergence, one way for blended finance to help overcome this challenge is by supporting transactions at the portfolio level (e.g. through pooled funds or facilities), as opposed to individual transactions at the project or company level. A portfolio approach helps to create larger deals, to increase diversification to reduce risks, and makes assessment and approval processes more cost-effective. This can also include a greater use of structured funds, which pool capital with different risk tolerance and return expectations, and which have proven to mobilise more commercial finance than flat funds and are more likely to reach a size of USD 100 million or more (Convergence, 2019[15]).

At the same time, greater standardisation in the blended finance field would lead to less complexity, lower transaction costs and greater transparency, which would enable more scalable approaches in response to the crisis. There is yet no standardised, ready-to-use model for a blended finance investment, and each vehicle is structured according to the specific needs of investors and local markets. This complexity prevents many mainstream investors from placing capital in blended finance vehicles (17 Asset Management, 2019[16]). In the guest contribution in Section 5.12, Global Affairs Canada stresses that for blended finance to be further scaled up, greater transparency is needed to improve the understanding of what works and where the effectiveness of blended finance mechanisms can be improved, when it comes to both financial performance and development impact. The author puts forward a set of actions that can be taken in this regard, including reaching broader agreement on standardised reporting requirements for different stakeholders.

Improved transparency will be even more urgent and important in the response to the COVID-19 crisis, to ensure that blended finance truly delivers optimal sustainable outcomes. To assist blended finance practitioners to better assess the impact of blended finance activities on poor people, the Tri Hita Karana (THK) working group on impact has developed a practical checklist, with a set of questions and screening considerations for the ex-ante assessment of the expected impact, as well as the ex-post assessment of the actual impact on the poor, in line with the Global Impact Investing Network's IRIS+ impact metrics (THK Impact Working Group, 2020[17]); (THK and IRIS, 2020[18]). The OECD Community of Practice on Private Finance for Sustainable Development is also planning further work on transparency, to measure impact and provide information for investors to evaluate the market.

Strengthening capacity in local capital markets will be crucial to increasing the uptake of blended finance transactions in LDCs. Palladium's guest contribution in Section 5.6 discusses the lack of local ecosystems of key actors, of local capital market integration, and of enabling policies, structures and capabilities and the resulting "market friction" as major barriers to the growth of blended finance in LDCs. The contribution argues the need to take a blended finance market development approach in LDCs, and describes Palladium's effort to strengthen transaction advisory and business development advisory services as a key component of that ecosystem to help generate specific blended finance transactions. GuarantCo's guest contribution in Section 5.9 highlights the low level of capacity in local capital markets to assess and price the credit (repayment) risk of infrastructure projects and proposes to overcome this challenge through a three-pronged approach: (i) using donor-funded guarantees to attract local investors, (ii) providing capacity-building to educate investors about how to assess the credit risk of infrastructure projects and (iii) establishing and developing local currency guarantors to support the development of local capital markets.

In the wake of the crisis, it will be critical for LDC governments to pursue relevant policy reforms aiming to improve the local investment climate. Development partners should support and co-ordinate efforts with the public sector to promote the reforms needed to create the policy and regulatory environment necessary to attract investors back to LDCs, including in specific priority sectors. Global policy-making discussions on increasing private finance flows existed before the COVID-19 crisis, but will be even more relevant given the additional challenges. For example, the G20 Compact with Africa was initiated in 2018 and aims to increase the attractiveness of private investment in African countries by improving macro, business and financing frameworks. So far, 12 African countries, seven of which are LDCs, have joined this effort. As a result, participating countries are speeding up the implementation of business environment reforms (IFC, 2019[19]).

From the consultations with blended finance experts conducted as part of this report, it emerged that pipelines of investment-ready sustainability projects in key sectors need to be developed for crisis-recovery financing. The blended finance community should be doing this now, even while the crisis is still unfolding. Developing a robust pipeline for post-crisis investments will position investors for when the recovery phase takes hold (Lee, 2020[20]). Even before the COVID-19 crisis, there was wide recognition of the shortage of investment-ready projects in LDCs and the costly and time-consuming pipeline origination and project preparation (OECD/UNCDF, 2018[21]); (OECD/UNCDF, 2019[22]). Projects in key sectors, as identified in tools such as the integrated national financing frameworks (INFFs) and nationally determined contributions under the Paris Agreement, should be prioritised (see Box 3.3 on integrating blended finance in INFFs). The United Nations global SDG investment platform, proposed by the GISD, could contribute to create the pipeline for SDG-enabling investments at large scale by filling market intelligence gaps and connecting investors to actionable investment opportunities (UNDP, 2020[23]).

The lack of investment-ready project pipelines also highlights the need for enhanced investment preparation capacities within governments and development institutions. Transaction and deal support, which is underdeveloped in most LDCs, will benefit from direct private sector expertise. At the country level, investment promotion capacities and investor one-stop centres could be further strengthened to identify sustainable investments. In addition, to support smaller-scale projects in LDCs to access additional finance, the provision of early-stage risk capital can often be critical (see the guest contribution in Section 5.10 from UNCDF's LDC Investment Platform team on addressing the "missing middle" challenge). Such capital, combined with technical assistance, helps to demonstrate commercial viability and address constraints such as a lack of collateral or credit history. UNCDF manages a portfolio of such risk-tolerant catalytic loans and guarantees on its balance sheet, which aim to de-risk early-stage enterprises and projects in LDCs to enable their access to additional finance. This support for "missing middle" finance in LDCs fills a unique niche in the development finance architecture, and UNCDF now aims to fully capitalise its LDC investment facility to scale up this support, in its capacity as an official international support measure for LDCs (UN, 2020[24]). As also highlighted in UNCDF's guest contribution in Section 5.8, the organisation is also establishing technical assistance facilities for two blended finance vehicles it helped establish, the BUILD Fund and the International Municipal Investment Facility, to support local partners on the ground to assess, identify and prepare investments.

Box 3.1. Multiplicity of risks and barriers to private investment

Risks and barriers to investment in LDCs are often compounded. The private sector finds it more difficult to invest in these countries because there are several challenges that prevent the market from functioning effectively. Very often, certain markets do not exist or there is a lack of data, information or capacity to properly identify and evaluate market opportunities. When an investment project can be designed, some risks need to be addressed to make the project investor-ready. Many of these risks, including a lack of collateral, foreign exchange risk and country risk, are exacerbated by the ongoing COVID-19 crisis. Common risks and barriers include:

- **Weak or inexperienced sponsors**. Lead investors with a limited understanding of project financing, technical capacity and size to absorb financing make it difficult to design and implement a good project.
- **First-mover costs**. Bringing a new technology or product to a market for the first time presents entry costs that are often not compensated by the expected returns until the market fully develops.
- **Lack of collateral/security**. Financing costs are often not covered by existing assets, and most sponsors in LDCs do not have the financial capacity to provide guarantees. This can be compounded by risks related to the enforceability of collateral.
- **High cost of capital**. Generating attractive returns in LDCs can be challenging, due to a combination of high local interest rates and relatively short terms on most deals.
- **Depth and breadth of capital markets**. Projects in LDCs often serve local markets, and therefore earn their revenues in local currency. However, local currency is rarely available at rates and tenors that would allow for an effective matching of assets and liabilities.
- **Foreign exchange risk**. Projects in LDCs are exposed to potential variance in foreign exchange rates, creating the possibility of gains or losses based on currency appreciation or depreciation. Projects that receive financing in international reserve currencies, but revenues in local ones, may be particularly exposed, reducing the attractiveness of returns from these countries.
- **Asymmetric information**. LDC markets are often marked by incomplete or limited information, at both the macroeconomic and the project levels, which may make accurate modelling difficult. Additionally, sponsors may be unwilling to invest in such regions without a firm understanding of the local environment.
- **Country risk**. LDCs are often particularly susceptible to geopolitical or macroeconomic risks. Many LDC governments face a high risk of debt distress and are constrained in their ability to assume more debt. High debt levels and poor credit ratings (for those LDCs that have a credit rating) can have an impact on a country's ability to mobilise private finance.
- **Weak governance and regulatory environment**. SDG-focused projects are often undertaken in conjunction with governments, or depend on conditions in the regulatory environment that also enable financial and other innovations. Real or perceived doubts over the efficacy or predictability of institutions in LDCs may reduce the appetite for outside investors to engage.
- **Lack of investment-ready projects** with high development impact potential combined with costly origination of pipelines of such investment-ready projects.
- **High transaction costs relative to deal size**. Investment projects in LDCs are on average smaller than in more developed economies, but require the same amount of time for due

diligence and so on as for larger deals. The cost of project preparation can also be higher in smaller, remote markets.

Further discussion of the typology of risks can be found in OECD DAC Blended Finance Principle 4, Detailed Guidance Note (OECD, 2020h[25]). See also Chapter 4, Barriers to private capital in least developed countries, in the 2018 version of this report series (OECD/UNCDF, 2018[21]).

For highly indebted countries that do not have unsustainable debt burdens, debt swaps for COVID-19 response, SDG and climate investments could be considered (UN, 2020[12])**.** Debt swaps would mean that debtor countries would agree with creditors to reallocate a part of the resources that have been budgeted for debt repayment to finance domestic projects that will contribute significantly to COVID-19 recovery and SDG progress. Under such debt swaps, one option could be for governments to allocate a portion of these resources for investments through blended finance vehicles, working in collaboration with development partners and other concessional finance providers. This could enable the mobilisation of sustainable private investments at large scale for building forward better post-COVID-19. While debt swaps to date have mostly been limited to smaller projects, some recent relevant experiences include a smaller sovereign debt swap for climate adaptation and impact investments in the Seychelles (Palladium, 2019[26]) and a proposal for swapping up to USD 1 billion in Caribbean external debt for annual payments into a climate resilience fund (Horgan, Murchison and Vaughan, 2020[27]). Larger-scale debt for climate and nature swaps with a focus on sustainable investments are gaining more interest, including a proposal for such an effort to back the LDC Group's 2050 Vision for a low-carbon, climate-resilient future, launched in 2019 (LIFE-AR, 2019[28]).

To best prepare the medium-term recovery, it is critical for LDC governments as well as their financing partners to draw lessons from past crises. For example, the global financial crisis highlighted the need for DFIs and regional development banks to play a countercyclical role and have a catalytic effect to crowd in commercial finance for the recovery in the most vulnerable geographies. To illustrate this, independent evaluations of the crisis performance of the IFC and the European Bank for Reconstruction and Development (EBRD) offer some useful evidence (Lee, 2020[20]). Both were key actors in tackling the crisis – the IFC because of its size and global scope, and the EBRD because of its private sector focus and operations in the region hardest hit by the global financial crisis, and because it was considered highly countercyclical.

In addition, the Ebola crisis demonstrated the importance for LDCs' governments to implement clear national recovery plans. One example of this can be found in Sierra Leone post-Ebola. The recovery plan clearly outlined the following three country priorities (Government of Sierra Leone, 2015[29]): (i) provide support to the agricultural sector, which may have suffered from a decline in agricultural outputs, (ii) restore tourism and attract private investment, as well as ensure the resumption of air and sea transport operations, given the restrictions on the movement of cross-border goods and services during the epidemics, and (iii) recapitalise financial institutions and support them to provide affordable finance for SMEs. Such national recovery plans should serve as a basis for blended finance actors when shaping responses post-COVID-19 and designing future blended finance transactions.

Expanding blended finance transactions to address liquidity and solvency by using debt and equity products will become more critical in the medium-term. Equity, including early-stage equity and quasi-equity, and subordinated debt, including in local currency, could prove particularly critical as we move from a liquidity crisis to a solvency crisis. However, this will involve taking greater risks in LDC markets; investors' ongoing perception of these markets as high-risk will likely still hinder the growth of private investment in the medium-term. In addition, development financiers, including DFIs, will likely have some distressed assets on their balance sheets as a result of the economic impact of the pandemic. When considering future investments, financiers will require more concessionality and will likely use more capital-intensive instruments, reducing their overall ability to extend their lending.

3.1.3. Managing risk will be critical to use blended finance effectively in LDCs

Managing risk will be critical for blended finance actors, especially in a period of extreme uncertainty and rapid evolution of risk (see Box 3.1)**.** Risk mitigation instruments need to be used even more strategically in the medium-term in LDCs. In such circumstances, blended finance is an effective approach to cover the risks that the private sector cannot mitigate (such as political, market or regulatory risk) and provide risk mitigation in areas where no or limited market solutions are available in this crisis context for de-risking (through, for example, insurance or guarantees). It should also be noted that guarantees are complicated instruments, especially in collaboration with the private sector, and can take several months or up to a year to set up for implementation.

DFIs are important actors in offering risk mitigation and should use their catalytic role to attract further investment in the mediu- term to build more resilient markets. DFIs have been at the centre of the discussions in the THK Roadmap for Blended Finance, as key actors with a clear catalytic role. In particular, taking on more risk for DFIs will mean focusing on more fragile countries and contexts, using catalytic instruments and focusing on sectors severely hit by the crisis. However, it should be noted that these institutions also face various challenges, including potential damages to their balance sheets. DFIs may also need to work with shareholders and rating agencies to accept a certain level of loss, as they direct more resources to LDCs. Box 3.2 discusses how DFIs can take on more risks (THK, 2020[3]) (see the guest contribution from Think Ahead Consulting on DFIs' role in Section 5.5).

Box 3.2. How development finance institutions can take on more risks

Established in Bali, Indonesia, in October 2018, the THK roadmap for blended finance is a unique platform for international dialogue on blended finance. It brings together stakeholders from all over the world, including donor agencies, DFIs, multilateral development banks, civil society organisations, philanthropic foundations, private sector stakeholders and impact investment communities.

A group of THK members has recently produced a paper recommending how DFIs and their shareholders could best speed up a sustainable and resilient recovery in developing economies and provide countercyclical finance to the most vulnerable, in response to the COVID-19 crisis.

One of the key proposals made in the paper is to ensure that DFIs undertake activities in riskier and more fragile environments, in particular in countries more severely hit by the crisis, by using a combination of financing mechanisms appropriate to each institution, such as accepting lower, risk-adjusted returns, optimising balance sheets and benefiting from enhanced guarantee mechanisms or a capital increase and, when appropriate, with the support of blended concessional finance.

As one option, shareholders could consider allocating additional risk-tolerant capital to a COVID-19 facility for micro, small and medium-sized enterprises that would help interested DFIs to manage more risk and mobilise more private finance through the use of subordinated instruments such as guarantees and concessional equity. This could be done by leveraging and expanding existing facilities that have the right capabilities, and, when appropriate, with the support of blended concessional finance.

Source: (THK, 2020[3]), The Role of DFIs and their shareholders in building back better in the wake of Covid-19, https://www.convergence.finance/resource/4OxhJkcGJgBzR1v1IJvKPs/view.

3.2. Key areas of focus for building forward better

Prioritisation of where to focus blended finance investments will be critical for LDC governments and their partners. With the present urgency and limited resources, blended finance should be applied in support of LDCs' national priorities in sectors and areas where the largest impact can be achieved in rebuilding more equitable, resilient and sustainable LDC economies and societies that accelerate the achievement of the SDGs in the coming decade. As countries define their post-COVID-19 development pathways for building forward better, they will need to balance the pursuit of economic value creation and diversification, the generation of decent jobs and inclusive growth, environmental sustainability and low-carbon development alongside good health. Building forward also means changing structures, systems and processes, to promote inclusive and sustainable growth. Overall, blended finance should be positioned as one tool in the financing toolbox to help demonstrate projects' viability and crowd in private investments in LDC priority sectors that contribute to achieving these multiple objectives, with a focus on investments that create jobs.

3.2.1. Attract investment in line with national SDG priorities

Inclusive country ownership will remain fundamental. Consulting and engaging with national and local governments as well as other non-state actors such as civil society and the private sector will ensure that the development projects chosen for investment are country-led and country-owned, in accordance with the Addis Ababa Action Agenda and the Kampala Principles. Development partners have yet to effectively engage national governments and incorporate a "whole-of-society" approach in their private sector engagement and blended finance efforts, according to the Global Partnership on Effective Development Cooperation[1] (GPEDC, 2019[2]) (see pages 44–45 of the 2019 edition of this report (OECD/UNCDF, 2019[22]) and the guest contribution in Section 5.1 on perspectives from Bangladesh on country ownership and alignment with national priorities).

To identify sectoral and other SDG priorities, blended finance providers should consult governments about priority sectors for development that could benefit from blended finance. This should include referencing and aligning with national SDG implementation plans and INNFs that have recently been developed or are under development in many LDCs (see Box 3.3 on INFFs). It should also involve reviewing any national strategies or response plans to address the COVID-19 crisis.

Box 3.3. Blended finance as an integral part of integrated national financing frameworks

Integrated national financing frameworks (INFFs) are country-owned tools to define financing needs and sources to achieve the SDGs. INFFs aim to link planning and financing processes and include four building blocks: (1) assessment and diagnostics, (2) financing strategy, (3) monitoring and review, and (4) governance and co-ordination.

The INFFs consider the full range of financing sources and means of implementation that are available to countries, and lay out a financing strategy to raise resources, manage country-specific risks and achieve long-term sustainable development objectives. INFFs can be useful tools, as financing is often the weakest component of national plans, and, in cases where financing plans are included, they mostly centre on annual government budgets without incorporating the broader financing landscape (UN, 2019[30]). The growing complexity of the development finance landscape and the mushrooming of internal and external actors and initiatives might hinder strategic approaches to managing financing flows.

If blended finance investments are properly integrated into the frameworks, the INFFs can provide means to track and manage private finance (and thus blended finance) and its contributions to the SDGs. Moreover, the UNDP's SDG impact initiative, aiming to direct private finance towards the achievement of the SDGs, can help to provide enterprises and investors with the tools they need to make more targeted investments and better-informed decisions (UNDP, 2020c[31]).

LDCs such as Bangladesh and the Solomon Islands have been among the early movers towards developing the building blocks towards INFFs and considering blended finance in an integrated manner. The Government of Bangladesh formulated a national policy on development co-operation that commits to further explore blended finance as a tool "to unlock private and philanthropic capital for development" (Government of Bangladesh, 2016[32]). This was followed by a domestic SDG financing strategy, further recognising the role of the private sector to finance the SDGs in the country (Government of Bangladesh, 2017[33]). The INFF of the Solomon Islands identified blended finance as a tool to catalyse further development finance as part of the country's strategic vision and direction (Solomon Islands and UNDP, 2018[34]).

Ensuring alignment with national climate and environmental priorities through nationally determined contributions (NDCs) under the Paris Agreement will be critical. Ahead of the United Nations climate change conference (COP26) in late 2021, countries are in the process of developing their NDCs to put in place low-carbon green economy plans. This provides an important opportunity to look at how blended finance can mobilise investments to support the implementation of these plans.

National SDG implementation plans and strategies, such as NDCs, will in most cases need to be further translated into more specific sector and sub-sector priorities where specific investment opportunities could be pursued. One useful resource in this regard is the IFC's country private sector diagnostic, which combines economy-wide and sector-specific analysis of constraints with the aim to identify private sector investment opportunities and policy actions to unlock these (IFC, 2020[35]). As of 2020, diagnostics have been undertaken in six LDCs (Burkina Faso, Ethiopia, Myanmar, Nepal, Rwanda and Senegal). In Senegal, for example, the analysis highlighted private sector investment opportunities in agriculture, education, tourism, and real estate and housing, which could unlock job creation, growth and structural transformation if a set of identified constraints are alleviated (IFC, 2020[36]). Another tool is the UNDP-led SDG investor map, which is an eight-step methodology to produce data and insights on country-level sustainable investment opportunity areas in key priority sectors and sub-sectors that would contribute to progress on the SDGs. Fourteen maps were produced in 2020 (two in the LDCs of Rwanda and Uganda), with several more planned for 2021 (UNDP, 2020[23]).

Co-ordination and strengthened collaboration will be critical, including with local actors such as national development banks. This is especially true as the crisis has limited international travel and created the need to staff up local capacity. Existing donor co-ordination groups at the country level can play an important role in gathering the main actors on the ground and rationalising and co-ordinating their efforts. Some donor groups already have their own dedicated working groups to discuss private sector engagement, including blended finance, while others review such issues in sectoral discussions. Development partners should make use of these groups where available and ensure that discussions go beyond simple updates on ongoing projects (GPEDC, 2018[37]). In addition, research from the Tony Blair Institute and CrossBoundary recommends that governments, DFIs and the private sector align approaches and synchronise efforts to scale up investment for COVID-19 economic recovery, including by co-ordinating on sector and sub-sector planning with governments (Cusack et al., 2020[38]). The Finance in Common Summit in November 2020 highlighted the importance of bringing together all actors in the development finance system, including those that have not always been integrated into the global development finance architecture, such as national and regional development banks. The guest contribution in Section 5.11 from the Overseas Development Institute (ODI) argues that national development banks (NDBs), present in almost two thirds of all LDCs, have a critical but often overlooked role to play in advancing the SDGs and the climate change agenda. NDBs are well placed to help leverage sustainable private investments if three preconditions are in place: (i) NDBs are well governed with a clear green mandate and business model to support the mobilisation of private finance, (ii) NDBs are adequately resourced, and (iii) NDBs receive international support, including from multilateral development banks (MDBs) and DFIs, and are provided with access to international concessional climate finance. The declarations of intent made at the Finance in Common Summit (Finance in Common, 2020[39]) will need to be operationalised and monitored to realise the vision of a fully integrated development finance system and its ability to support the world's most vulnerable people.

Identifying specific priority investments will also require using ex-ante evaluation criteria to ensure investments have optimal development impact, such as reaching the last mile and vulnerable populations, providing essential goods and services with large SDG-positive spillover effects, and driving job creation, regional integration, supply and value chains, and economic growth. To optimise the development impact of blended finance investments and ensure the best possible use of taxpayer resources, it is important to compare and balance the amount of "leverage" (amount of commercial finance raised by every donor dollar) and the development "additionality" that blended finance vehicles bring, as examined by CrossBoundary's guest contribution in Section 5.4 through the example of two use cases of blended finance. In addition, DFIs and MDBs should adhere to the MDBs' harmonised framework for additionality in private sector operations (IFC, 2018[40]) and employ their ex-ante evaluation tools to determine anticipated impact and inform investment decisions (see the guest contribution in Section 5.2 from the IFC on the anticipated impact measurement and monitoring (AIMM) system). UNCDF's approach to measuring results attempts to capture both financial and development additionality through a formal theory of change and an integrated results and resources matrix that sets out a series of performance indicators at both the investee and the policy or market system level (OECD, 2020[41]). The SDG impact standards for private equity funds, recently released by the United Nations Development Programme (UNDP), are a useful tool for investors to systematically identify, optimise and manage sustainable development impacts (UNDP, 2020[42]). The OECD, in collaboration with the UNDP, is currently developing impact standards on financing for sustainable development, to serve as a tool for donors to manage the sustainable development impacts of their investments made through private sector partners.

3.2.2. Get people back to work in decent, sustainable jobs

According to the International Labour Organization (ILO), the pandemic has put nearly half of the world's 3.3 billion workforce at risk of losing their livelihoods (ILO, 2020[43]); (ILO, 2020[44])**.** Income losses are expected to exceed USD 220 billion in developing countries (UNDP, 2020[45]). The share of

labour income lost in low-income countries during the first three quarters of 2020 was 10.1%, close to the global average of 10.7% (ILO, 2020[43]). This loss in income translates into 19 million full-time-equivalent jobs lost in low-income countries. Particularly in LDCs, hard-hit sectors have a high proportion of workers in informal employment and workers with limited access to health services and social protection. The different types of jobs and the lack of information technology infrastructure in LDCs make working from home impossible for most people. Among those most exposed to the immediate social impacts of COVID-19 are young people, and in particular young women, who tend to be over-represented in LDCs' sizeable informal economies, lack savings and work in the economic sectors that have been most impacted by social distancing restrictions (UN/DESA, 2020[46]). Weak social protection systems and low levels of fiscal stimulus in these countries mean that this loss in income is likely to push a higher share of households into poverty than in countries with better social protection and larger stimulus programmes (ILO, 2020[43]). The loss of livelihoods will reverberate across societies, impacting education, human rights and, in the most severe cases, basic food security and nutrition (UNDP, 2020[45]).

Central to restarting and rebuilding LDC economies should therefore be a focus on creating, and employing people in, decent and productive jobs. It is widely accepted that the most effective and sustainable way to achieve inclusive and sustainable development is to create jobs offering higher wages and better working conditions (UN, 2017[47]). Blended finance should prioritise providing needed capital in LDCs to help protect and create jobs, sustain the self-employed, and support companies' liquidity and operations, to accelerate the recovery in the future.

Enterprises and sectors with strong job creation potential should be identified and targeted by blended finance providers. For example, two thirds of LDCs' labour force are engaged in agriculture as a main source of livelihood, and agriculture growth is two to three times more effective in reducing poverty in Africa than growth in any other sector (UNCTAD, 2018[48]). Small and medium-sized enterprises (SMEs) in the agriculture sector are critical to linking production with markets, but due to high lending risks and lower returns in the sector, agricultural SMEs have limited access to capital. There is an estimated USD 65 billion annual financing gap for agricultural SMEs in the missing middle in sub-Saharan Africa (see the guest contribution in Section 5.10 from UNCDF's LDC Investment Platform team). In East Africa, for example, 65% of the population works in the agriculture sector, which accounts for 25% of GDP but receives only 5% of commercial bank lending (Aceli Africa, 2020[49]). The situation is similar in Asia-Pacific LDCs. Blended finance holds significant potential to mobilise resources into agricultural finance ecosystems, including in LDCs. The OECD, together with the Smallholder and Agri-SME Finance and Investment Network (SAFIN), has conducted a deep-dive on mobilising private finance for agri-SMEs through blending. Box 3.4 provides insights on a case study of a blended finance project in Bhutan focused on sustainable agriculture.

Box 3.4. A blended finance approach to agriculture: evidence from Bhutan

Blended finance support to create higher productivity, and more sustainable and climate-resilient agricultural value chains, could help to create jobs. The OECD and the Smallholder and Agri-SME Finance and Investment Network (SAFIN) have been researching the deployment of blended finance approaches in the agricultural sectors in developing countries, including LDCs. The following example is of a blended approach for sustainable hazelnut production in Bhutan.

In 2015, the Asian Development Bank (ADB), the Private Sector Window of the Global Agriculture and Food Security Program (GAFSP), and the IFC made an equity investment of USD 12 million in Mountain Hazelnuts, a social enterprise promoting hazelnut production by smallholders across Bhutan.

The IFC and the ADB invested USD 3 million of equity each, while existing shareholders of Mountain Hazelnuts converted USD 3 million of existing bridge loans into equity. The Private Sector Window of the GAFSP agreed to invest quasi-equity of USD 6 million, matching the total amount of the IFC's and the ADB's investments. The use of resources from the Private Sector Window of the GAFSP in the form of cumulative redeemable preferred shares (CRPSs) was essential to mobilise the funding from the IFC and the ADB, and to close the remaining funding gap for the project's completion. Given the high-risk profile inherent in this semi-greenfield project, neither the IFC nor the ADB would have invested without substantial support from the GAFSP. CRPSs, technically an equity instrument senior to all other share classes, work like a loan with a fixed coupon and redemption timeline and no dilution to other shareholders. However, the biggest advantage they offer to the company and its shareholders is that the base internal rate of return is in the form of a dividend payment and is cumulative. This means that it does not have to be paid mandatorily by the company to GAFSP every year.

The overall expected financial returns on GAFSP Private Sector Window projects are in the single digits. However, while ensuring financial returns for investors, the projects have also delivered significant development impact results: alleviating poverty among farmers, linking them to markets, creating jobs and developing skills, increasing women's participation in the job market, restoring Bhutan's eroded landscape, mitigating greenhouse gas emissions, preserving forests and reducing or slowing down urban migration towards the capital.

This project case study presents lessons on the importance of fully understanding the challenges and detecting the issues across a complex supply chain. Thousands of farmers are scattered throughout a wide and impenetrable terrain, requiring appropriate monitoring systems and processes. The management needs to be strong, experienced and capable to quickly respond with adequate, often pre-emptive, measures to unexpected issues, and make such a risky project a success.

Source: This case study related to the IFC's blended finance investment in Mountain Hazelnuts was contributed by Niraj H. Shah (Principal Investment Officer, IFC, and Program Manager, GAFSP, Private Sector Window) and Philipp Farenholtz (Investment Officer, IFC). Further insights on this case study can be found in a 2020 report (SAFIN and IDB, 2020[50]).

Digital solutions and innovations have proved particularly important in ensuring business continuity and the protection of jobs. From virtual meetings to online orders, digital services are growing in importance, permeating an increasing number of sectors and activities. Digitally agile firms are adapting to the ongoing crisis more successfully, and others are rapidly adopting digital innovations in response to challenges to their business models (WEF, 2020[51]). Investing in digital solutions and competitiveness will therefore be key to promoting resilient economic recovery as well as both protecting jobs and creating new ones. The guest contribution in Section 5.7 from UNCDF's Financial Inclusion practice highlights how digital innovations have enabled rapid growth for a wide range of SMEs and business models in different sectors that can now leverage blended finance solutions to reach large scale.

The crisis can be an opportunity to refocus blended finance to address concerns around impact to place a stronger and more explicit focus on job creation. In the consultation with experts to inform this report, it emerged that, with the expected influx of public spending and grants to respond to the crisis, there is an opportunity to incentivise or require private sector recipients of public support to protect or create decent jobs and, more broadly, to incorporate and drive sustainability through their business models. The pandemic has also underscored the importance of investing in productive capacities in the LDCs (including in areas such as energy, telecommunications, infrastructure and entrepreneurship) to create jobs, enhance resilience to shocks and drive structural transformation towards more diversified economies. To ensure maximum impact, results-based blended financing instruments could also be used in certain sectors, where it could be possible, for example, to include incentives to retain workers as conditions of loans.

The following sections highlight several areas and sectors that are critical for job creation and long-term sustainable economic growth in LDCs, that could be prioritised by blended finance providers.

3.2.3. Focus on small and medium-sized enterprises

SMEs are engines for growth and need to be supported to stimulate the recovery and job creation. SMEs account for 35% of formal jobs in LDCs, and medium-sized national industries are often made up of dynamic firms with solid growth potential to generate jobs and boost value addition in national products (UNCTAD, 2018[48]). They also tend to have strong production linkages with the national economy and serve as key players in regional value chains. However, SMEs in low-income countries face significant constraints in accessing finance. On average, 22% of all SMEs globally report being fully credit-constrained, while in low-income countries the share is almost double (42%) (IFC, 2017[52]).

SMEs based in LDCs have been severely affected by the crisis. Preliminary findings from a survey on the state of SMEs in LDCs conducted by a consortium of organisations, including UNCDF, show that due to COVID-19, 87.9% of SMEs report that they operate on less than 75% business capacity, 34.6% have laid off staff, and 33.9% indicate that they are at risk of shutting down within three months (UNCDF et al., 2020[53]). SMEs in the textile, personal care, hospitality and energy sectors are affected worse than businesses in sectors such as financial, professional and technology services (ibid.). Women-led businesses report higher rates of lay-offs (36.9%) and risks of closure (39.5%). SMEs report the lack of access to customers and suppliers as the main challenges caused by the pandemic (ibid.). SMEs in LDCs also have a high share of direct exports, for example in the furniture-making sector, and have been impacted by the global supply chain disruptions caused by the crisis (WTO, 2020[54]). Overall, SMEs in the Asia-Pacific LDCs seem to be faring better than SMEs in sub-Saharan Africa in terms of operational capacity and anticipated revenue loss, as 51.7% of Asia-Pacific SMEs, versus only 24.6% of SMEs in Sub-Saharan Africa, report being at between 50% and 100% operational capacity (UNCDF et al., 2020[53]).

Innovative blended finance could be part of the solution to providing the financing support needed by SMEs. This is especially true for small and growing businesses, the so-called missing middle (for more information on the challenges of missing-middle financing, see page 17 of the 2018 report (OECD/UNCDF, 2018[21]) and page 17 of the 2019 report (OECD/UNCDF, 2019[22])). MDBs and DFIs as well as local banks tend not to serve this enterprise segment because of high risks (real and perceived) and high transaction costs. Providing support – through loans or guarantees, for example – to local financial institutions that on-lend to local SMEs can help to ensure access to finance.

Blended finance vehicles that target this financing gap do exist. For example, all the following use blended finance to increase access to finance for SMEs: the BUILD Fund, managed by Bamboo Capital and supported by UNCDF (see the guest contribution in Section 5.10 from UNCDF's LDC Investment Platform team), Boost Africa, a joint initiative between the African Development Bank and the European Investment Bank (EIB), with a first loss tranche provided by the European Commission that invests in SME funds in Africa (African Development Bank, 2020[55]), and, the EIB's SME Access to Finance Initiative, which offers medium- to long-term funding and a partial portfolio guarantee (EIB, 2020[56]). Other noteworthy initiatives include Aceli Africa (Aceli Africa, 2020[49]), which offers portfolio first-loss coverage and origination to address the mismatch between the risk-return hurdle of lenders and the demand for capital among agri-SMEs, and the African Guarantee Fund, which provides financial institutions with loan portfolio guarantees and other financial products and financial incentives to secure existing portfolios of loans to SMEs (African Guarantee Fund, 2020[57]). In the wake of COVID-19, innovative blended finance solutions such as these targeting LDC-based SMEs in the missing middle should be scaled up and replicated, recognising the important roles of SMEs in creating much-needed jobs.

3.2.4. Systematically support women and girls to accelerate the recovery

Women play a vital role in economic and sustainable development, but face additional challenges under the COVID-19 crisis. It is therefore critical to prioritise investments that economically empower and create jobs and livelihoods for women. Women are disproportionately more impacted by economic shocks, are at a greater risk of being laid off, and have lower access to social protections (Narayan, 2020[58]). Women are more likely to hold less secure jobs in the informal economy, and generally earn less than men. Women are also likelier to work in the front-line health and service sectors, increasing their exposure to the virus Moreover, lessons from the Ebola epidemic suggest that the negative impacts on women's economic livelihoods are longer-lasting than those for men. In addition, the 2X Challenge and the Gender Finance Collaborative stress that the COVID-19 pandemic has and will continue to magnify pre-existing gender inequalities and vulnerabilities (2X Challenge, 2020[59]).

Blended finance can be employed to provide liquidity or working capital to financial institutions and intermediaries that incorporate a gender lens, cater to women borrowers, such as microfinance or SME lenders, concentrate on women-focused fund managers, and target sectors with high levels of female representation (2X Challenge, 2020[59]). For example, the IFC is providing pooled first-loss guarantees to support new working capital loans to SMEs in low-income countries, with special incentives for financial institutions that target women entrepreneurs (IFC, 2020[60]). In April 2020, the 2X Challenge put out a call to action to DFIs, private sector investors and other financial intermediaries to ensure that gender dynamics are incorporated into their COVID-19 crisis responses (2X Challenge, 2020[59]). The recommendations are focused on rapid crisis response – including providing direct financial and advisory support, liquidity or working capital to financial intermediaries that incorporate a gender lens, and investing in solutions to improve gender-disaggregated data. In the longer term, it will also be important to finance and prioritise vehicles, facilities and other gender-smart solutions that "increase resilience to future pandemics and other shocks from a gender equality perspective" (2X Challenge, 2020[59]). Investments must be made in areas such as childcare support and women's economic empowerment that facilitate female participation in the workforce. The Impact Investment Exchange (IIX)'s Women's Livelihood Bond, which provides a guarantee of 50% of the loan principal, has a USD 500,000 first-loss tranche, and is listed on the Singapore stock exchange. It is an innovative example of how blended finance can support women-led social enterprises to build their resilience to socio-economic shocks in Asia. It is also a model that could be scaled up or replicated (IIX, 2019[61]).

3.2.5. Support health systems

Ensuring that health systems are properly resourced, in terms of both finance and supplies, is key for both the response and recovery to the pandemic and for resilience to future health crises. Blended finance can be used to help mobilise additional finance towards the dissemination of vaccines in LDCs. Using advance market commitments, "concessional funders guarantee the future purchase of a service/product not yet available, or not available in a particular market at a specific price" (Apampa, 2020[62]). This financial commitment could help to provide accelerated, affordable and large-scale vaccine availability and distribution in LDCs.

Blended finance can also play an important role in supporting health system recovery and resilience (for more on the potential of blended finance in supporting health systems, see pages 45–47 of the 2019 edition of this report (OECD/UNCDF, 2019[22])). In response to COVID-19, there are growing calls from LDCs to develop industries to domestically produce vital medical supplies, including test kits, medicines and personal protective equipment. In addition, health infrastructure, including adequate hospital capacity, clinics and beds, is crucial to building resilience. A blended finance mechanism could be employed to help finance the production and manufacturing of pharmaceutical products and the development of health infrastructure. For example, the Investment Fund for Health in Africa is a private equity fund focused on privately backed healthcare SMEs. The fund targets SME healthcare providers in

the sectors of care provisioning (hospitals, clinics and similar care providers), healthcare product manufacturing and supply, and wholesale and distribution in sub-Saharan Africa. The fund includes guarantees and insurance from public and philanthropic investors (IFHA, 2020[63]). The International Committee of the Red Cross programme for humanitarian impact investment uses an impact bond, where results-based financing is provided by public investors based on performance, to leverage funding from private institutional investors to deliver comprehensive physical rehabilitation services in conflict and post-conflict countries on the African continent (Convergence, 2020[64]).

However, blended finance investments in health should carefully consider existing issues in the health systems of developing countries, such as fragmentation and inequalities. The choice of financing mechanisms to deliver healthcare services should be based on their ability to ensure that they benefit citizens and address inequalities (OECD DAC, 2020[65]). Blended finance models could explore how to expand and deepen social protection. For example, concessional finance could play a role in closing the gap between the low premiums that individuals can pay and the greater actuarial risks. Blended finance providers should contribute to building the evidence base, assessing the impact of blended transactions on both the expansion of health coverage (quantity) and on its affordability, accessibility and appropriateness (quality) (Eurodad, 2019[66]).

Blended finance solutions could be employed to scale up e-health solutions to support LDCs and help to reach the most vulnerable populations. Private sector-developed e-health solutions, including contact tracing, telemedicine and mobile health applications, have also proved useful in supporting health systems during the pandemic. For example, LDCs have used chatbots to transmit practical information and best practices, and contact tracing applications to enable the rapid identification of new cases (UNCDF, 2020[67]). Moreover, the United Nations Technology Bank for the Least Developed Countries has launched a technology matchmaking platform to scale up the local production of essential COVID-19 technologies (Tech Access Partnership, 2020[68]). Concessional finance providers should provide incentives for the private sector to engage in these solutions to support urgent health needs and boost long-term pandemic preparedness and resiliency planning.

3.2.6. Target sectors that are critical for inclusive, resilient and sustainable development

In the medium to longer term, it will be important to focus blended finance investments on projects and sectors that increase the resilience of economies and societies to future crises. Examples include climate-compatible infrastructure (especially in health, and water and sanitation; see Box 3.5), clean energy, oceans-based sectors, digital finance and e-commerce solutions, including sectors that have received low volumes of blended finance to date. Recognising that not all sectors are currently able to generate sufficient financial returns for most private investors, there are nevertheless opportunities in sectors that traditionally have been overlooked. Such upfront investments are likely to be less costly than responding to and rebuilding from future disasters and shocks. Many of these sectors also hold strong potential for job creation, especially for youth, and help to drive more rapid structural transformation (Africa Growth Initiative, 2019[69]). Enabling policies and targeted finance solutions for companies in these sectors would further contribute to job creation and help to build stronger, more sustainable and more resilient systems for the future.

The importance of transport and infrastructure was highlighted during months of border closures, disruptions in the delivery of essential supplies and shortages of food stuffs, especially in landlocked LDCs. It is also important to ensure the affordability and accessibility of products and services, especially for the most vulnerable. For example, the guest contribution in Section 5.8 from UNCDF's Local Development practice points to the rapid urbanisation in many LDCs and the investment opportunities that growing and more productive cities can bring. However, capital investments are not increasing, due to underdeveloped domestic capital markets and the lack of ability of most municipalities to borrow from

international markets. Blended green finance could be part of the solution, and a growing number of cities' networks and DFIs are coalescing around an agenda focused on blended finance for municipal development (for more on this, see pages 47–48 in the 2019 report). Moreover, while water and sanitation is still one of the least targeted sectors in blended finance, and investments in this sector's management have historically been financed by the public sector, OECD evidence shows that blended finance can play a critical role in mobilising commercial finance as well as strengthening the financing systems on which water-related investments rely (OECD, 2019[70]). Box 3.5 presents a case study on a water-related project financed through a blended finance approach in Uganda.

Box 3.5. Blended finance in WASH: case study from Uganda

Water, sanitation and hygiene (WASH) services are an essential part of protecting human health during infectious disease outbreaks, as well as enabling schools, workplaces and other public places to maintain effective hygiene protocols as they reopen (World Bank, 2020[71]). The OECD has studied blended finance in the water and sanitation sector (OECD, 2019[70]). The following case study illustrates a successful example of a blended finance project in WASH in an LDC, Uganda.

Challenge

Bugala Island is the largest of 84 islands that make up the Ssese archipelago in Lake Victoria, Uganda. Bugala Island was previously one of Uganda's poorest districts and had a constant shortage of potable water. The majority of the population used lake water, which is not safe for bathing or consumption. In addition, the existing pipe network in Kalangala, a town on Bugala Island, needed replacement.

Solution

In 2005, InfraCo Africa, a company in the Private Infrastructure Development Group (PIDG), established Kalangala Infrastructure Services (KIS) to address these issues. KIS operates as a multi-sector utility and has been responsible for the investment and maintenance of the water infrastructure for five years. KIS's investment in water infrastructure was part of a broader multi-sector initiative to improve access to water, safer transportation and more reliable, renewable (solar) electricity. The project had four infrastructure components: the development of two passenger ferries; the development of a 1.6 MW solar-thermal hybrid power generating station; investment in water infrastructure; and road upgrade. The total investment for the four projects was USD 49 million, inclusive of USD 6.3 million for project development costs.

Blended finance approach

KIS was financed with a commercial loan of USD 5 million from Nedbank as well as a combination of debt and equity from various DFIs, including the Emerging Africa Infrastructure Fund (EAIF) and a joint debt guarantee from the United States Agency for International Development (USAID) and GuarantCo. PIDG technical assistance provided an output-based aid grant of USD 5 million, used to fund the construction of the first ferry. InfraCo Africa maintains a 54% equity stake in the project. Kalangala funded its investment with an output-based aid grant from PIDG technical assistance of USD 5 million and a USD 5 million commercial loan from Nedbank, alongside DFI loans and equity funding totalling USD 22.4 million, including USD 7 million from the EAIF. The project reached financial closure in December 2012.

Results

KIS constructed six water treatment systems, which have a total capacity to extract over 250,000 litres of water per day, and reservoir tanks and storage facilities for 200,000 litres. Those villages now supplied with clean, safe water have seen an 80% drop in waterborne disease. As a result of safe water supply services, the population on Bugala Island has experienced a reduction in medical expenses. KIS water systems have created direct jobs through the management of the water meters and have led to increased farming activity on the island. In addition, the project will provide much-needed access to infrastructure for the Bugala Island residents, which will improve economic development – including access for tourism and fishing, a key industry – and quality of life. Moreover, during the life of the project, there have been improvements in the regulatory environment, including the creation of the first private sector water authority in Uganda.

Source: (OECD, 2019[70]) Making Blended Finance Work for Water and Sanitation: Unlocking Commercial Finance for SDG 6, https://dx.doi.org/10.1787/5efc8950-en

Clean energy is a crucial enabling sector for all economic activities, for building resilience and achieving the SDGs. While energy is the sector where blended finance has mobilised the most private finance in LDCs (see Figure 4.12, Chapter 4), there is still far from enough investment going to clean and renewable energy in LDCs. Despite progress towards sustainable energy access in many LDCs, more than 60% of people in LDC populations lacked access to electricity in 2017 (UNCTAD, 2017[72]). More than 40% of LDC businesses are held back by inadequate, unreliable and unaffordable electricity. Achieving SDG 7 on universal access to energy by 2030 in LDCs would require a 350% increase in the annual rate of electrification and an estimated minimum of USD 12 billion annual investments (ibid.). At the same time, investments in green sectors and green jobs such as in renewable energy, are generally more labour intensive, so investing in them can help to expand employment (UN, 2020[73]).

More blended finance funds and facilities can help fill this energy gap and catalyse larger, utility-scale, transformative investments to drive low-carbon resilient development and jobs in LDCs. One example of such a larger-scale blended finance facility is Climate Investor One (CI1), focused on financing projects in low- and lower middle-income countries in the wind, solar and hydro sectors. It focuses on 11 countries, of which five are LDCs (Burundi, Djibouti, Madagascar, Malawi and Uganda) (Green Climate Fund, 2018[74]). Following a notable investment by the Green Climate Fund along with the Netherlands, the European Union, the Nordic Development Fund and USAID, the CI1 facility closed at USD 850 million in June 2019, with some USD 620 million in commercial equity mobilised from investors in Africa, Europe and the United Kingdom. CI1 comprises three funds tailored to finance each stage in a project's lifecycle: the development fund for the development stage, including pipeline development; the construction equity fund for construction; and the refinancing fund for operations. Based on the experience of CI1, its approach will be replicated and scaled up through the establishment of a next vehicle, CI2, to address adaptation challenges focusing on water, sanitation and ocean systems (Choi and Seiger, 2020[75]).

Investments in digital infrastructure and solutions are imperative for exiting this crisis and helping to build more resilient economies and workforces. While mobile phone and mobile Internet usage is growing rapidly in LDCs, only 19% of the population in LDCs were online in 2019, compared with 86.6% in developed countries and 47% in developing countries. Women access the Internet at a much lower rate than men in LDCs (ITU, 2019[76]). This is due mainly to a lack of digital infrastructure and broadband connectivity, and prohibitively expensive access. This digital divide threatens to reinforce the socio-economic consequences of the pandemic. Investment in digital infrastructure and affordable connectivity is therefore one area where blended finance can play an important role. For example, as part of its strategy to grow the digital economy and public services, the Government of Rwanda is mobilising concessional investment to deploy last-mile solutions and middle-mile networks to connect over 1,700 schools to the

Internet, as well as healthcare centres and public institutions that lack broadband connectivity (Giga, 2020[77]).

Supporting the transition to inclusive digital economies in the next decade will be key to creating a new generation of jobs in LDCs. It is estimated that up to 230 million digital jobs can be created in sub-Saharan Africa by 2030, which could generate up to USD 120 billion in revenue (IFC, 2019[78]). Blended finance can play a key role in helping to create such jobs by supporting small and growing digital entrepreneurs that provide digital solutions benefiting the most vulnerable, and the SDGs more broadly; supporting digital supply chain management in sectors where significant numbers of poor people are engaged (e.g. garment manufacturing, agriculture, health); and supporting digital solutions for businesses and value chains in real economy sectors that have been affected by the crisis and that vulnerable populations rely on. For example, in the Pacific, UNCDF is working with mobile network operators to temporarily waive fees for domestic transactions and incoming remittances (UNCDF, 2020[67]). In Malaysia, UNCDF launched a challenge to find solutions to improve the financial health of gig workers. In Uganda, the organisation is supporting motorcycle service SafeBoda to pivot its business from ride-sharing to the home delivery of food, medicines and other goods. This will save the jobs of SafeBoda's 18,000 drivers, help them to reach at least 28,000 customers, create market access for 800 vendors and enable successful social distancing efforts in Kampala. See the guest contribution in Section 5.7 from UNCDF's Financial Inclusion practice on digital innovations, which highlights the potentially significant opportunities that digital innovations can provide in mobilising and aggregating micro-savers in LDCs to become micro-investors in local development projects through the use of innovative blended finance mechanisms.

In small island developing states, which heavily rely on oceans-based industries, blended finance efforts could focus on opportunities to scale up or replicate innovative "blue" blended finance schemes, such as blue bonds, debt-for-ocean swaps, blue carbon schemes, insurance schemes to cover oceans-related risks, or impact funds for oceans-based activities (OECD, 2020[79]) (see Box 3.6 on blended finance for blue economies).

Box 3.6. Investing in green and blue economies – biodiversity and ocean finance

The world is facing a rapid and unprecedented terrestrial and marine biodiversity crisis. Since 1970, 68% of all wildlife populations have been lost, and by 2050 more than a million species are expected to become extinct. Eleven million hectares of primary forest were lost in 2019 alone, and half of all coral reefs, home to 30% of all marine biodiversity, have been lost over the past 30 years (Ervin, 2020[80]). Healthy ecosystems provide oxygen, clean water and food, and their losses put humanity at risk. LDCs depend on biological resources to a great extent, and ecosystem loss has significant and disproportionate impacts on LDC economies and societies.

Blended finance is growing as an approach to finance sustainable economic activities that protect biodiversity, where investor risk is seen as high, and viable and scalable business models are tested. To date, blended finance transactions have mainly focused on sustainable agriculture and sustainable forestry, and the most common approaches have been through pooled solutions (Johnston, 2019a[81]). As the world prepares for the UN Biodiversity Conference (COP 15) in China in 2021, which will result in a new set of global goals for nature over the next decade, blended finance will have an important role to play.

Examples of blended finance programmes in the biodiversity space include the following.

- The **Tropical Landscapes Finance Facility** issued the world's first sustainable land-use bond (USD 95 million) for a conservation-friendly rubber plantation in Indonesia, tapping mainstream capital markets, thanks to a guarantee issued by USAID (WEF, 2020[82]).
- The **Land Degradation Neutrality Fund** invests in viable private projects that support land rehabilitation and sustainable land management, including sustainable agriculture, sustainable livestock management and agro-forestry. With a USD 2 million initial grant from the Global Environment Facility to help kick-start the fund, it had mobilised some USD 150 million by October 2020.

Moreover, many LDCs, particularly small island developing states, rely largely on sustainable ocean economies, where large proportions of economic activity stem from ocean resources. Blended finance can help to mobilise additional finance towards sustainable ocean economies in developing countries (OECD, 2020[83]). Innovative blended finance instruments have been employed for the sustainable oceans economy:

- The **Global Fund for Coral Reefs** is a new blended finance vehicle that will leverage grants, debt, guarantees and other financial instruments for investments in blue economy activities, such as sustainable fisheries and tourism that support coral reef conservation and resilience (Conservation Finance Alliance, 2020[84]).
- **Impact investment funds** have emerged in the past five years to attract commercial finance for sustainable ocean economies, mainly focusing on marine conservation, sustainable fisheries, and marine plastic litter and/or the circular economy. The United States, for instance, has provided loan guarantees to several of these funds, including the Althelia Sustainable Ocean Fund, the Meloy Fund and Circulate Capital's Ocean Fund (OECD, 2020[83]).

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Note

[1] A mapping of 919 development co-operation projects involving the private sector in Bangladesh, Egypt, El Salvador and Uganda carried out by the Global Partnership for Effective Development Co-operation showed that only 13% of the projects studied listed national governments as partners, and even fewer projects listed other stakeholders (civil society, 9%; business associations, 5%).

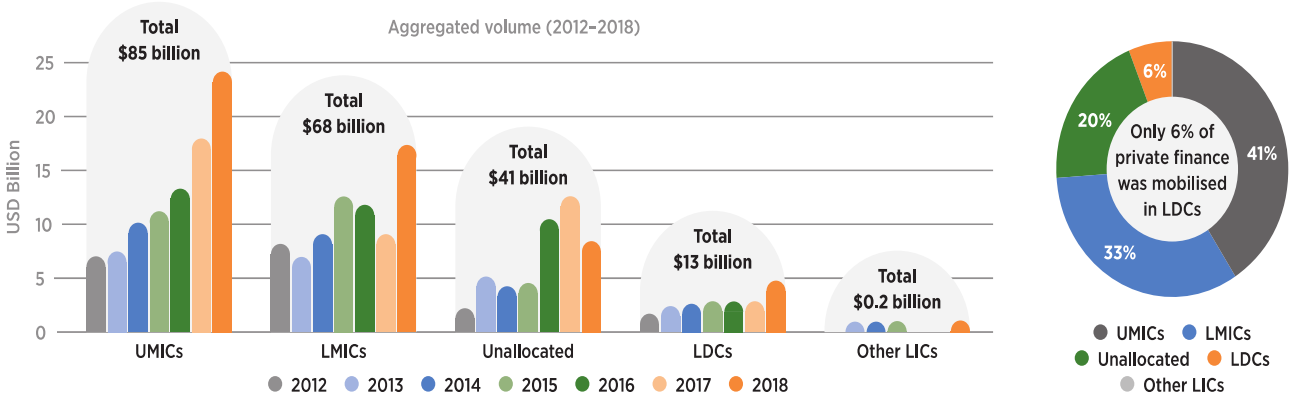
4. The state of blended finance in least developed countries (2012–2018)

This chapter depicts the latest trends in private finance mobilised by official development finance interventions, and the state of blended finance in least developed countries (LDCs). It identifies the main mobilisers of private finance in LDCs and the top recipient regions, countries and sectors. It also provides an analysis of the leveraging mechanisms used to mobilise private finance in LDCs.

4.1. Least developed countries continue to receive the lowest share (although increasing in volume) of private finance mobilised by official development finance interventions

The latest OECD data show that LDCs, compared with other country groupings, continue to receive the lowest share of private finance mobilised by official development finance interventions. Between 2012 and 2018, around USD 13.4 billion was mobilised in LDCs – a mere 6% of the total. This compares with over USD 84 billion (41%) in upper middle-income countries and USD 68 billion (33%) in lower middle-income countries (Figure 4.1).

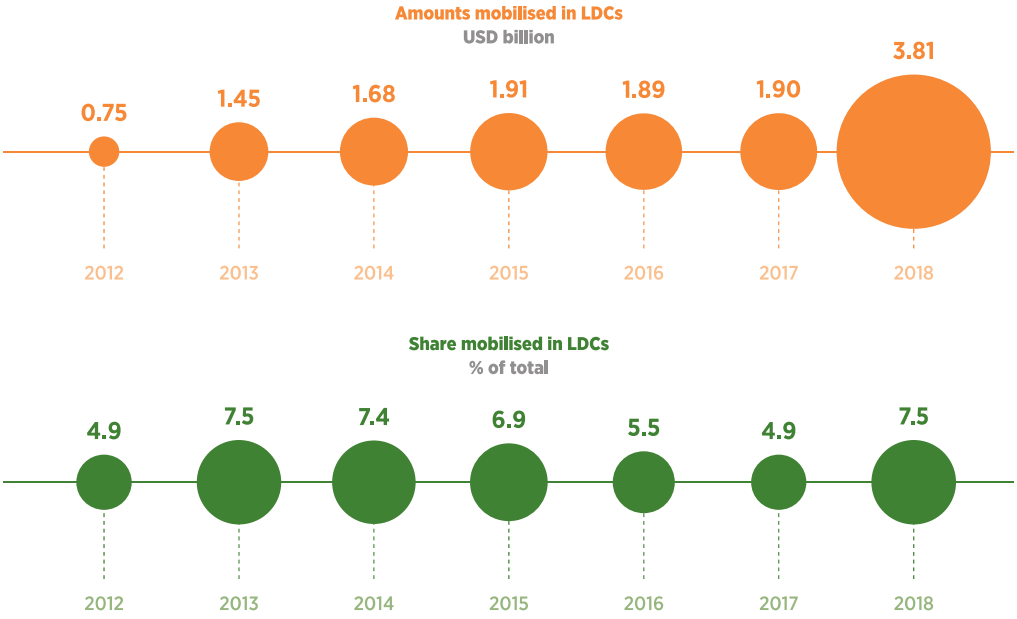
Figure 4.1. Private finance mobilised in LDCs, compared with other country groupings (2012–2018)



Note: LDCs = least developed countries; LICs = low-income countries; LMICs = lower middle-income countries; UMICs = upper middle-income countries.
Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm.

As Figure 4.2 shows, in 2018 private finance mobilised in LDCs doubled with respect to the previous year – from USD 1.9 billion in 2017 to USD 3.8 billion in 2018. This represents a remarkable increase with respect to earlier years, where the share of private finance mobilised for LDCs was on a slightly upward trend (2012–2015) or constant (2015–2017). However, gaps in the data series might cause a loss in precision and possible bias in the estimates of yearly changes. While the significant increase in 2018 might reflect an actual improvement, the main reason for the increase is the fact that, in 2018, the International Finance Corporation (IFC) reported project-level data with details on the recipient countries/territories, which was not the case in previous years. Indeed, as pointed out in our 2019 report (OECD/UNCDF, 2019[2]), the data on the amounts mobilised by the IFC in 2016–2017 were not broken down by recipient for confidentiality reasons. This severely hinders comparability of data over the years.[1]

Figure 4.2. Amounts mobilised from the private sector in LDCs (2012–2018)



Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm.

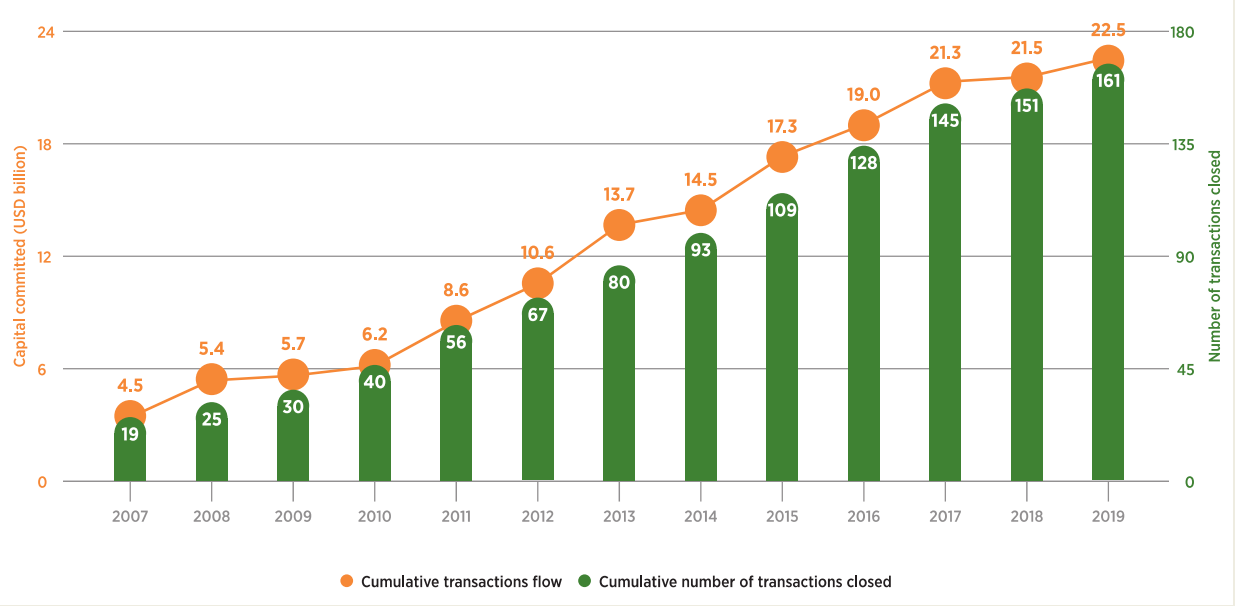
Analysis by Convergence, which uses its database of concessional blended finance transactions (see Annex C for Convergence's methodology), points to slightly different estimates of blended finance targeting LDCs, which is likely to be partly due to differences in definitions and in the nature of the datasets (see Box 4.1).

Box 4.1. Latest trends in concessional blended finance transactions in LDCs

According to the Convergence database, 161 blended concessional finance transactions have targeted one or more LDCs to date, representing around a quarter of total blended concessional finance transactions (26%) and up to USD 22 billion in total financing. Approaching half of these transactions (44%) have exclusively focused on LDCs, with another third (32%) having a primary focus on LDCs (more than half of priority countries in the case of multi-country transactions).

Figure 4.3 shows that there has been an overall slight increase both in the aggregate number and in the aggregate volume of blended concessional finance transactions targeting LDCs. There was an increase in 2019 by about 7% in the aggregate number of transactions (151 in 2018 versus 161 in 2019) and by 4.5% in volume. The yearly increase had been more pronounced in past years.

Figure 4.3. Cumulative blended finance targeting LDCs



Source: Data received from Convergence (unpublished).

Blended concessional finance transactions targeting one or more LDCs (with an exclusive or partial focus) have been smaller compared with other blended concessional finance transactions, both in terms of average size (USD 140 million versus USD 250 million overall) and median size (USD 50 million versus USD 57 million overall). Consequently, blended concessional finance transactions targeting LDCs account for only 17% of the aggregate transaction volume of all blended finance transactions.

The majority of these transactions are funds (e.g. debt fund, equity fund; 41%), followed by projects (e.g. infrastructure projects, health programmes; 25%) and companies (e.g. social enterprises, alternative finance companies; 20%). Over the past decade, there has been a relative increase in projects (from 22% of blended concessional finance transactions between 2010 and 2014, to 31% of transactions between 2015 and 2019), and a relative decrease in funds (decreasing from 43% to 38%) and companies (decreasing from 22% to 9%).

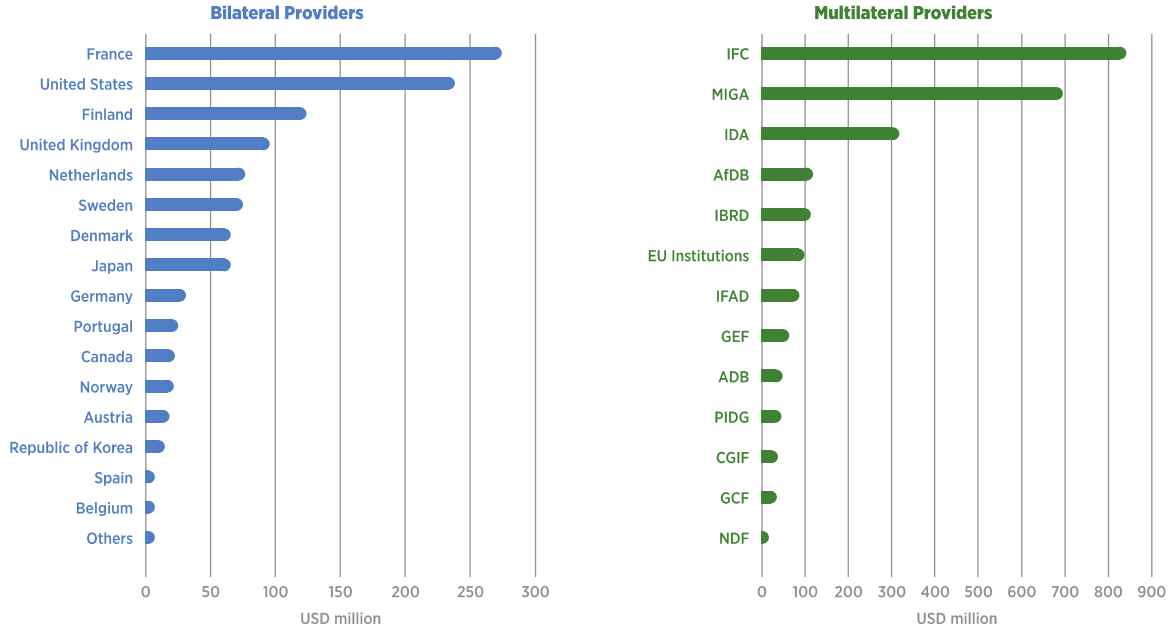
Interestingly, according to Convergence data, almost half of blended finance transactions target bottom-of-the-income-pyramid populations as end beneficiaries (49% of transactions between 2014 and 2019) across LDCs and middle-income countries (Convergence, 2020[3]).

Note: Convergence tracks country data by stated countries of focus at the time of financial close, not actual investment flows. Often, countries of eligibility are broader than those explicitly stated. See Annex C for the data methodology.
Source: Data kindly provided by Ayesha Bery, Associate, Convergence.

4.2. Multilateral institutions mobilise the largest amounts of private finance in least developed countries

As Figure 4.4 shows, on average in 2017–2018, the largest amounts of private finance in LDCs were mobilised by multilateral providers, mainly the IFC, the Multilateral Investment Guarantee Agency and the International Development Association (IDA), followed by the African Development Bank, the International Bank for Reconstruction and Development (IBRD) and European Union institutions. This is consistent with trends in previous years. While bilateral donors tend to mobilise smaller amounts, they are increasingly engaging in blended finance approaches in LDCs. Among bilateral providers, France ranks first in terms of average amounts mobilised over the same period, followed by the United States, Finland, United Kingdom, Netherlands and Sweden. These are the bilateral donors with the most-established blended finance programmes in LDCs, in which they engage either through their DFI (such as the United States through its new DFI, the Development Finance Corporation) or directly (such as Sweden, whose aid agency carries out most of the development co-operation portfolio, including using blended instruments such as guarantees).

Figure 4.4. Private finance mobilised across official development finance providers (average 2017–2018)



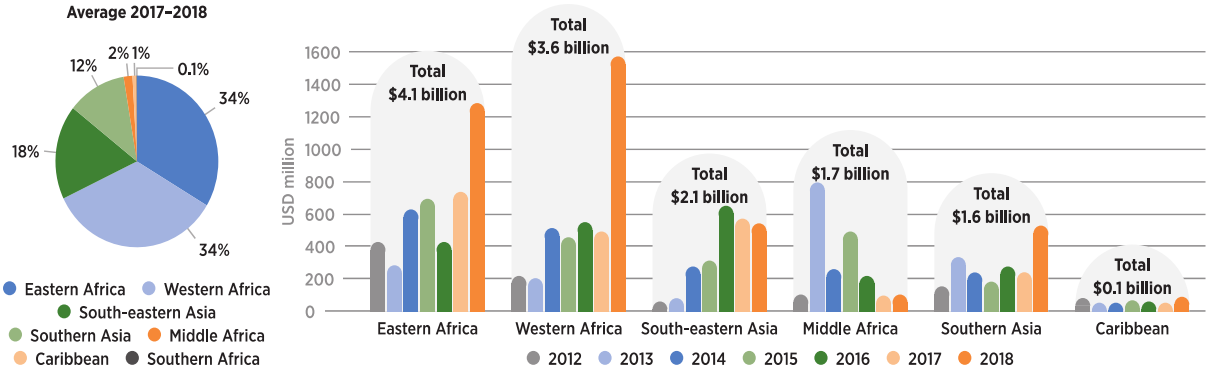
Note: ADB = Asian Development Bank; AfDB = African Development Bank; CGIF = Credit Guarantee and Investment Facility; EU = European Union; GCF = Green Climate Fund; GEF = Global Environment Facility; IBRD = International Bank for Reconstruction and Development; IDA = International Development Association; IFAD = International Fund for Agricultural Development; IFC = International Finance Corporation; MIGA = Multilateral Investment Guarantee Agency; NDF = Nordic Development Fund; PIDG = Private Infrastructure Development Group
Note: "Others" include Australia, Czech Republic, Ireland, Luxembourg, Slovak Republic, Slovenia and Switzerland. For the IFC, the data available were for 2018 only
Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm.

4.3. Least developed countries in Eastern and Eestern Africa receive the largest amounts of private finance mobilised

In terms of regional allocation, on average in 2017–2018 the largest share of private finance (70%) was mobilised in sub-Saharan Africa, followed by South-eastern Asia (18%), Southern Asia (12%) and the Caribbean (1%) (see Figure 4.5). In sub-Saharan Africa, an equal share of 34% was mobilised in Eastern Africa and Western Africa, while 2% was mobilised in Middle Africa. Very low amounts were mobilised in Oceania. However, it is important to remember that the figure shows data on LDCs, and most (33) LDCs are in Africa, followed by nine in Asia, four in Oceania and only one (Haiti) in Central America. This regional allocation reflects that of previous years and is broadly similar to the geographical allocation of ODA. As seen in Figure 4.5, while Eastern Africa has been the largest recipient subregion over the 2012–2018 period, Western Africa experienced the largest increase of private finance mobilised from 2017 to 2018, more than doubling and reaching USD 1.5 billion in 2018. Eastern Africa also saw a significant increase in 2018 (+80%), with USD 1.2 billion mobilised, as did Southern Asia (USD 479 million) and the Caribbean (USD 39 million). By contrast, amounts mobilised in South-eastern Asia decreased slightly from 2017 to 2018 (-5%), to USD 492 million.

The data show a significant increase in the amounts received in 2018 with respect to previous years, which, again, is mostly due to the availability of country-level data from the IFC, as well as an overall increase in the amounts mobilised by the World Bank Group, in particular the IDA, the IFC and the Multilateral Investment Guarantee Agency (MIGA). This could be related to the IDA-IFC-MIGA Private Sector Window, which aims to catalyse private sector investment in the world's poorest countries (i.e. only those eligible for IDA funding), including fragile and conflict-affected situations (see the guest contribution in Section 5.2 from the IFC) – however, this will most likely be reflected in the data in the next years, if data are disclosed at a disaggregated level.

Figure 4.5. Regional allocation of private finance mobilised in LDCs (average 2017-2018)



Note: The sub-regional classification reflects that of the United Nations (UN, 1999[4]). The sub regions of Melanesia, Micronesia, Southern Africa and the Middle East were not included in the figure, as the amounts mobilised there were negligible compared with other sub regions.
Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm

To date, very limited blending has taken place in fragile contexts, with most private finance mobilised in fragile situations being geographically concentrated in Africa and, to a lesser extent, Asia. The OECD has conducted a deep-dive on blended finance in fragile contexts; its main takeaways are presented in Box 4.2.

Box 4.2. Can blended finance work in fragile contexts?

Despite growing donor recognition of the imperative to address fragility[2] to leave no one behind, blended finance is often omitted in development co-operation strategies to address fragility. Of the 47 LDCs, 18 identify themselves as fragile and have signed the New Deal for Engagement in Fragile States (International Dialogue on Peacebuilding and Statebuilding, n.d.[5]). Most OECD Development Assistant Committee (DAC) members and other donors have developed specific development co-operation strategies to guide their interventions in fragile contexts. Yet these strategies often bear no specific reference to the role of private investors. Those that do, often focus on capacity-building and private sector development. Some multilateral development banks have adopted an explicit focus on mobilising additional private finance for fragile and conflict situations. Most bilateral DFIs limit their interventions to private sector development, and only a minority have explicitly committed to mobilising private finance in fragile contexts.

Blended finance opportunities in fragile contexts are influenced by risk perceptions and income levels. On average, blended finance deals in more stable developing countries mobilised more than double the volume reported in fragile settings. This speaks to the more careful engineering required and the smaller ticket size that can be achieved in fragile contexts. Countries that reported mobilising no private finance scored significantly worse across all fragility dimensions. In general, opportunities for blended finance increase with national income. The level of domestic income will also influence the average amount of private finance mobilised and its origin. When blending in fragile LDCs, more private money is raised per deal from the domestic economy, than from the donor country.

There are opportunities for blended finance to increase with economic, environmental and political stability. On average, higher amounts of private finance were mobilised in countries described as more economically, environmentally and politically stable. Societal fragility and security did not, however, have a decisive influence on the amounts of private finance mobilised during the time analysed.

Several blending instruments are available for donors, but their relevance to addressing fragility remains extremely context-specific. The following are examples of blended finance instruments in fragile contexts.

- The **Afghan Credit Guarantee Foundation** (ACGF) was started by the German development co-operation with the United States Agency for International Development (USAID) and is now also supported by the World Bank. The ACGF aims to improve access to finance for micro, small and medium-sized enterprises (MSMEs) in Afghanistan by providing credit guarantees and technical assistance to banks and microfinance institutions.
- The **Central Africa SME Fund**, launched by the fund manager XSML in 2010, provides private equity, long-term debt and technical assistance to small and medium-sized enterprises (SMEs) in the Central African Republic and the Democratic Republic of the Congo. The USD 19 million fund leverages technical assistance grants to support SMEs pre- and post-investment.
- The **Humanitarian Impact Bond** is a pooled vehicle of USD 27 million, issued by the International Committee of the Red Cross to fund physical rehabilitation centres in the Democratic Republic of Congo, Mali and Nigeria, with a results-based framework.

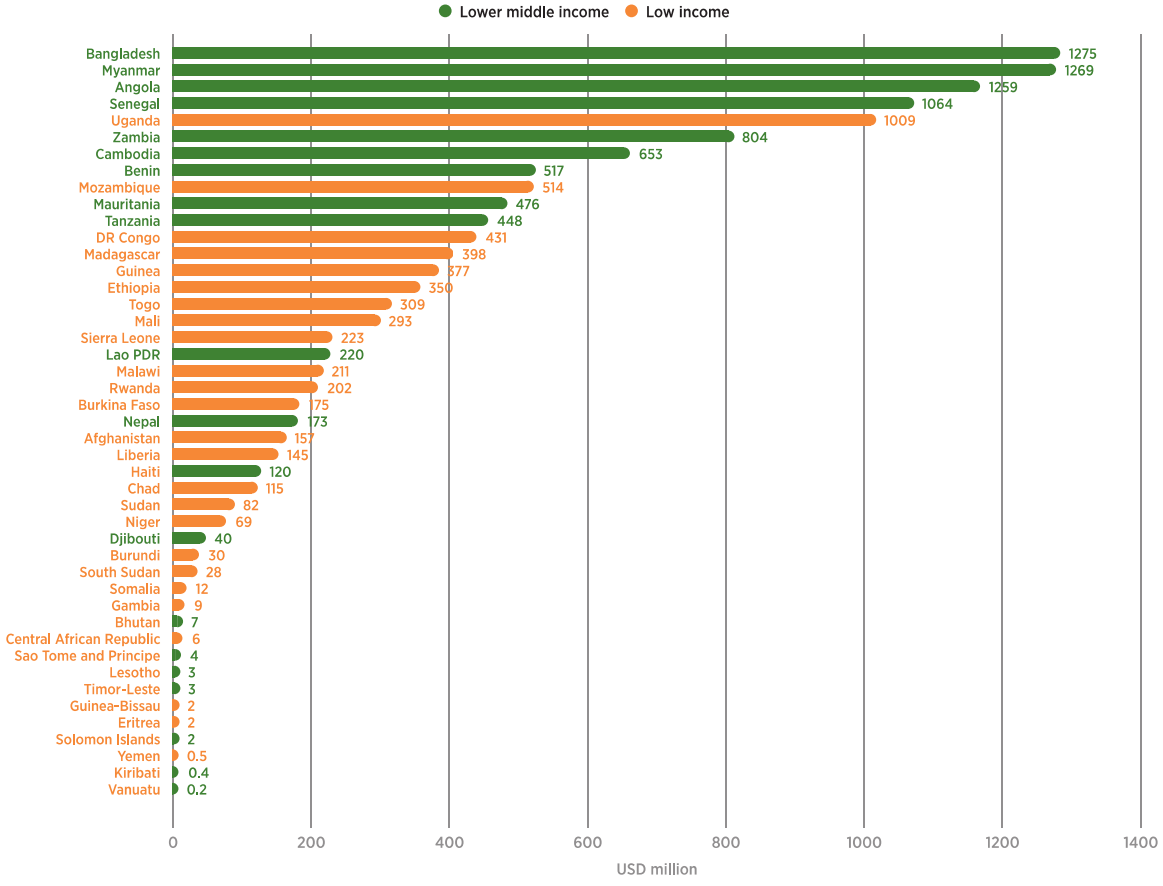
Ultimately, blended finance efforts must rest on continued support to the enabling environment. Blended finance in fragile contexts requires the presence of strong institutions committed to improving the ease of doing business, attracting foreign investment and spurring domestic private sector growth.

Source: (Basile and Neunuebel, 2019[6]), Blended finance in fragile contexts, https://dx.doi.org/10.1787/f5e557b2-en.

4.4. Private finance was mobilised in two additional least developed countries in 2018

Over the 2012–2018 period, 45 out of the 47 LDCs received private finance mobilised by official development finance at least once. Since our 2019 report, two additional LDCs – the Central African Republic and Lesotho – have received private finance mobilised by development finance from two bilateral providers. Figure 4.6 below shows an overview of the cumulative volume mobilised in each LDC over the 2012–2018 period. Overall, the LDCs that received the largest amounts of private finance mobilised belong to the lower middle-income group (under the World Bank's classification), whereas most of those receiving the lowest amounts are low-income. The exceptions are small island developing states, which are lower middle-income countries (as opposed to low-income). Over the period analysed, the top five LDCs in terms of the cumulative amount of private finance mobilised are: Bangladesh, Myanmar, Angola, Senegal and Uganda.

Figure 4.6. Cumulative volume of private finance mobilised in each LDC (2012–2018)

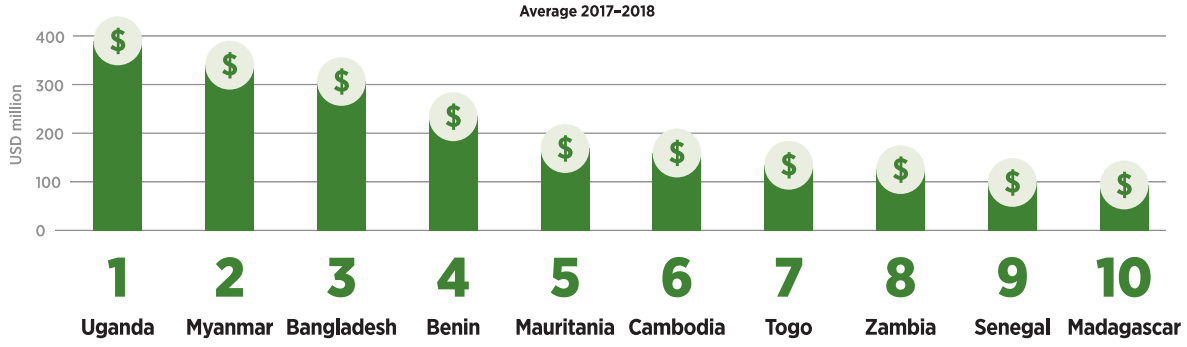


Note: The income-group classification refers to that of the World Bank Group.
Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm.

Figure 4.7 shows the top ten recipient LDCs in 2017–2018. Among these, Uganda ranks first, with nearly USD 390 million mobilised, followed by Myanmar (USD 339 million) and Bangladesh (USD 306 million). Among Asian LDCs, Cambodia also figures among the top ten recipients. Among African LDCs, Benin,

Mauritania, Togo, Zambia, Senegal and Madagascar are those with the largest volumes of private finance mobilised. The private finance mobilised as a share of GDP[3] varies across the top recipients, from 0.12% and 0.45% in Bangladesh and Senegal, respectively, to between 2.4% and 2.6% in countries such as Togo and Mauritania. This quite closely reflects the trends of previous years, but with some notable differences. While Angola was the largest recipient country in previous years, it ranked only 21st in 2017–2018. However, this fluctuation is likely to be the result of relatively large transactions in Angola in previous years in the hydroelectric power and manufacturing sectors (MIGA, 2015[7]); (MIGA, 2016[8]). Angola is the only LDC among those that are scheduled for graduation from the LDC category (Angola, Bhutan, Sao Tome and Principe, Solomon Islands and Vanuatu[4]) that received significant amounts of private finance mobilised. Among those LDCs that are eligible for graduation but not yet scheduled to graduate,[5] Myanmar and Bangladesh have received relatively high shares of private finance over the years, followed by Nepal and the Lao People's Democratic Republic, while Kiribati, Timor-Leste and Tuvalu are still among the least targeted.

Figure 4.7. Top ten LDCs in terms of average volume of private finance mobilised



Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm.

These trends are broadly consistent with the findings emerging from Convergence data on blended finance transactions (see Box 4.3).

Box 4.3. Country allocation of blended finance transactions – historical data

According to the Convergence database, the most frequently targeted countries in terms of average transaction size are Zambia, Mozambique, Senegal, Rwanda and Uganda (with Uganda and Tanzania being among the top five targeted countries across all blended finance transactions). In recent years, blended finance activity has expanded to new LDCs, including within sub-Saharan Africa (e.g. Madagascar, Malawi and Mali) and in new regions such as South-eastern Asia (e.g. Cambodia). While these latter countries have not been targeted as frequently as Uganda and Tanzania, transaction count is not necessarily correlated with transaction size. For example, while Uganda received the highest number of transactions (58), its transaction sizes have on average been smaller (averaging USD 140 million) than in less frequently targeted countries, including Mozambique (USD 190 million) and Senegal (USD 180 million).

Figure 4.8. Top LDCs targeted in blended concessional finance transactions



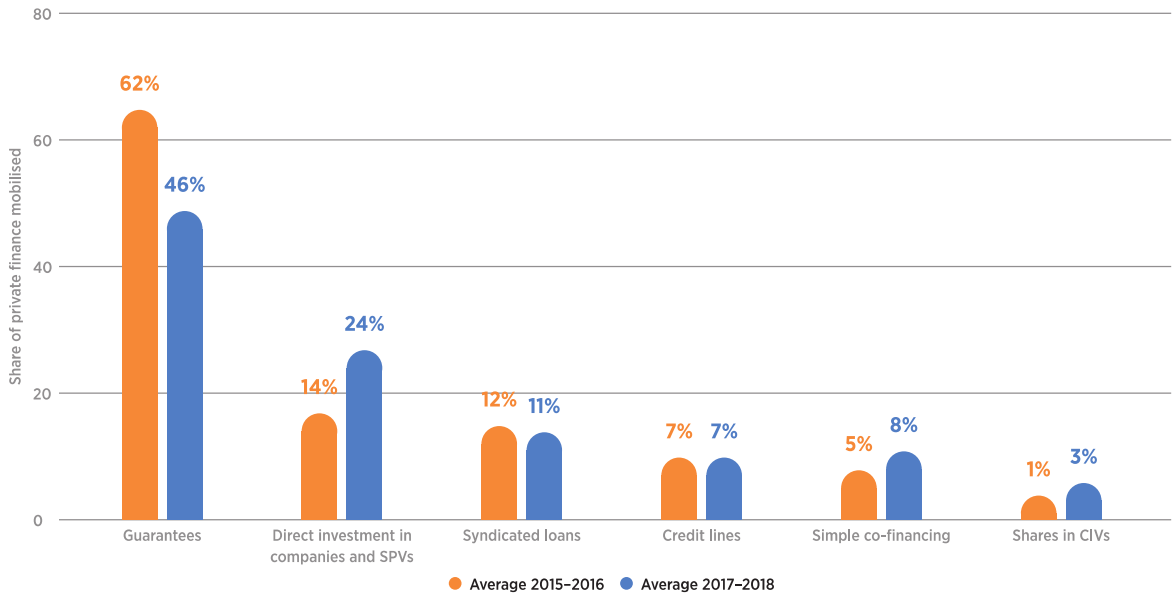
Note: See Annex C for the data methodology
Source: Data received from Convergence (unpublished).

While guarantees mobilised the largest share of private finance in LDCs, direct investment in companies and special purpose vehicles (SPVs) experienced the highest increase in 2017–2018.

As Figure 4.9 shows, guarantees mobilised the largest amounts of private finance by official development finance interventions in LDCs, followed by direct investment in companies and SPVs and syndicated loans. In particular, guarantees mobilised on average 46% of the total in 2017–2018, considerably lower than in 2015–2016 (62%). Direct investment in companies and SPVs (i.e. equity investments) mobilised 24% of the total on average in 2017–2018. This represents a remarkable increase (up by 10%) with respect to previous years.[6] However, this is likely to be uneven across countries, as LDCs have varying levels of development of equity markets and often challenging business environments. Moreover, while the average share of private finance mobilised by syndicated loans (11%), credit lines (7%) and shares in collective

investment vehicles (CIVs) (3%) remained constant over the years, simple co-financing schemes rose from 5% in 2015–2016 to 8% in 2017–2018.

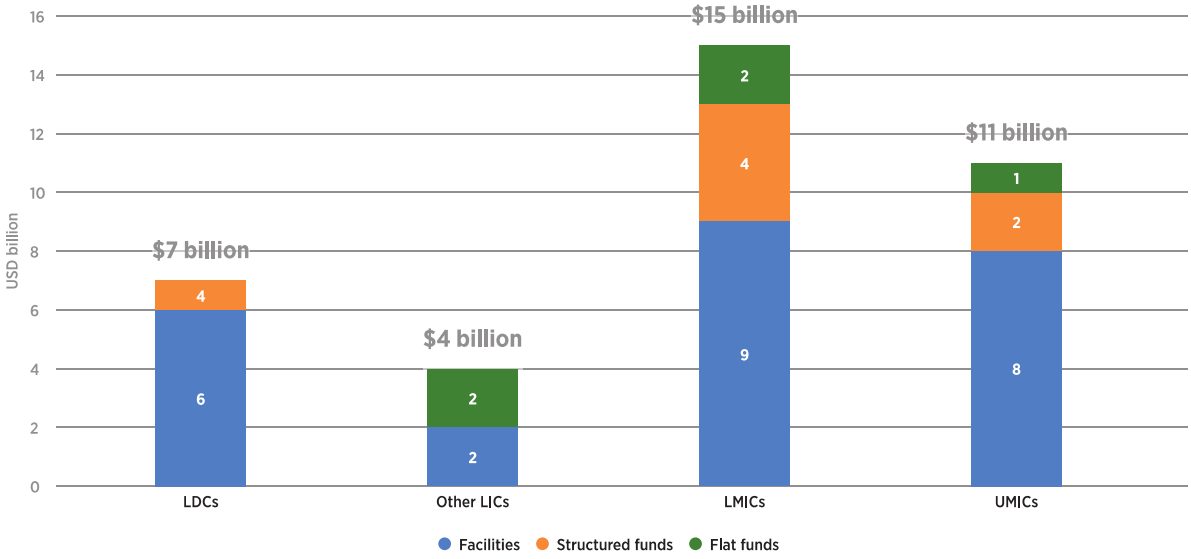
Figure 4.9. Share of the total private finance mobilised in LDCs by leveraging mechanism



Note: CIV = collective investment vehicle; SPV = special purpose vehicle
Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm.

Among CIVs, the OECD distinguishes two types of vehicle: funds and facilities. Box 4.4 explains the difference between a fund and a facility. The OECD conducts an annual survey to estimate the investment size, strategy and other aspects of blended finance funds and facilities (see Annex C: Methodology). According to the latest survey, blended finance CIVs invested USD 7.6 billion in LDCs (i.e. 20% of the total reported in developing countries), comprising both development and commercial finance (Figure 4.10). Of the USD 7.6 billion invested in LDCs, the majority of investments were made by blended vehicles with concessional finance, while only a small portion of finance (4%) was provided from commercial sources (especially through funds). Overall, more commercial finance was mobilised in structured rather than flat funds, particularly those structured as private equity, thereby confirming the benefits of a diversified strategy in attracting different investor profiles. Moreover, structured funds are generally more likely than flat funds to reach a size of USD 100 million or greater. This could support the hypothesis that structured funds may be better suited to mobilising larger amounts of finance. In contrast, investment in lower middle-income countries sourced relatively less concessional finance, while commercial finance accounted for about 10% of the total (Basile and Dutra, 2019[9]).

Figure 4.10. Blended finance funds and facilities: assets under management by country grouping (2017)



Note: LDCs = least developed countries; LICs = low-income countries; LMICs = lower middle-income countries; UMICs = upper middle-income countries
Source: (Basile and Dutra, 2019[9]), Blended Finance Funds and Facilities: 2018 Survey Results, https://dx.doi.org/10.1787/806991a2-en.

Box 4.4. What is the difference between a blended finance fund and a facility?

Blended finance funds are pools of capital composed of mixtures of development and commercial resources that provide financing to direct investees (e.g. projects or companies) or indirect investees (e.g. through credit lines or guarantees) that provide on-lending. In addition to mobilising commercial capital at the fund level, this type of CIV may also mobilise additional financing at the project level. Funds can be structured in two ways – either in a flat structure where risks and returns are allocated equally to all investors (all investors are pari passu) or in a layered structure where risks and returns are allocated differently across investors.

Blended finance facilities are earmarked allocations of public development resources (sometimes including support from philanthropies) that can invest in development projects through a range of instruments, with the purpose of mobilising additional finance (e.g. commercial) through their operations. Facilities can be set up in many different ways, with distinct terms of operations and mandates. For example, three potential types of facility may be characterised as follows: (1) managed by governments, providing concessional financing and often investing in funds (e.g. the European Commission's blending facilities and the Green Climate Fund); (2) managed by a DFI or a private asset manager, providing concessional finance (e.g. the Access to Energy Fund from the Dutch entrepreneurial development bank, FMO); and (3) managed by DFIs, on commercial terms (e.g. those by CDC).

Source: (Basile and Dutra, 2019[9]), Blended Finance Funds and Facilities: 2018 Survey Results, https://dx.doi.org/10.1787/806991a2-en.

Moreover, Convergence identifies four ways in which concessional finance can be deployed by public and/or philanthropic actors to mobilise additional financing for the SDGs in developing countries (i.e.

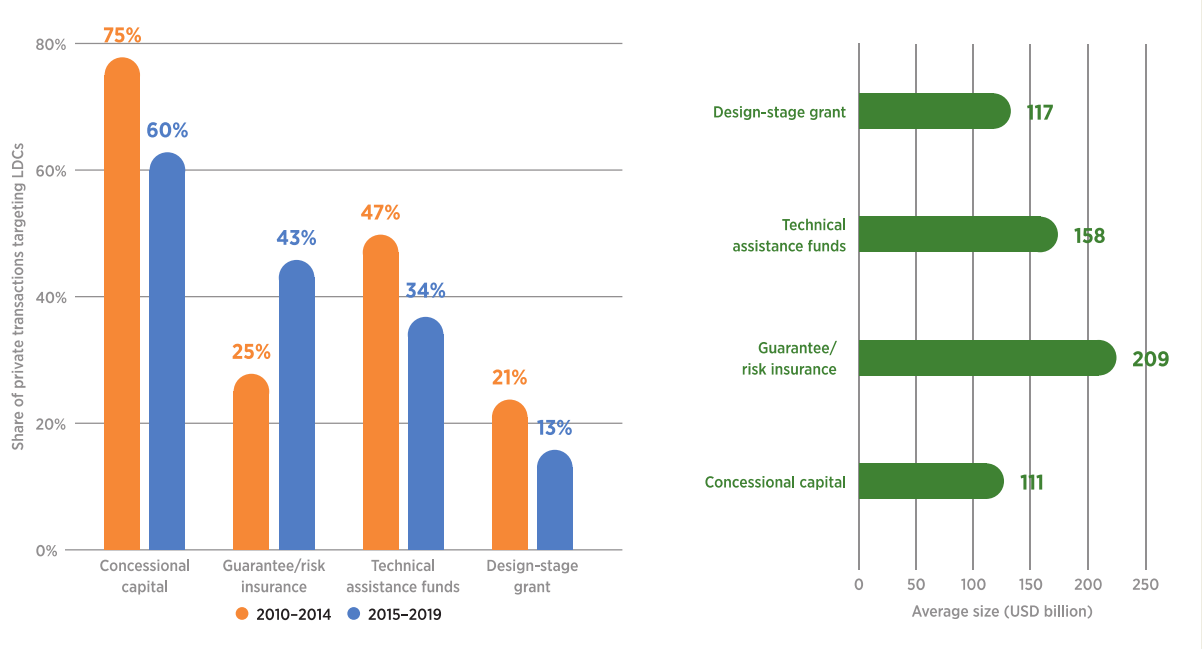
through concessional debt or equity, guarantees or risk insurance, design/preparation grants and technical assistance funds). Box 4.5 shows that most blended concessional finance transactions in LDCs benefit from concessional finance, with the share of concessional finance decreasing over time.

Box 4.5. Blending archetypes in LDCs

The vast majority of blended finance transactions targeting one or more LDCs benefit from concessional finance within their capital structure (e.g. first-loss, concessional equity). In particular, over the 2015–2019 period, about 60% of transactions deployed concessional finance. The share of concessional finance has decreased over time, as it stood at 75% in 2010–2014 (see Figure 4.11).

Compared with all blended concessional finance transactions, transactions targeting LDCs have been more likely to deploy technical assistance alongside investment capital (47% versus 36% of all transactions). However, this has been on a decreasing basis: while 47% of transactions deployed technical assistance in 2010–2014, this dropped to 34% in 2015–2019. This follows overarching trends in the blended finance market. Meanwhile, guarantees are becoming increasingly popular as blending instruments for transactions targeting LDCs, rising from 25% of transactions to 43% over the same period. This is partly due to the increasing proportion of projects in these markets. Guarantee or risk insurance transactions are also associated with a larger average size (USD 209 million), compared with other instruments. Blended transactions with concessional finance have the lowest average size, at USD 111 million.

Figure 4.11. Blending archetypes in LDCs

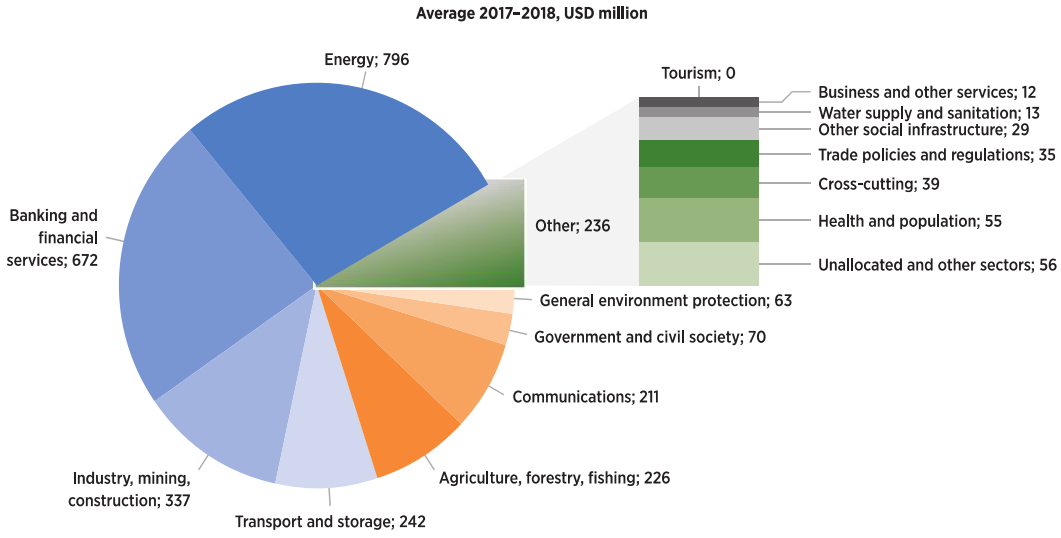


Source: Convergence

4.5. Most private finance mobilised in least developed countries is concentrated in the energy, banking and financial services sectors

As Figure 4.12 shows, the top three recipient sectors of private finance mobilised in LDCs are energy (USD 796 million on average in 2017–2018), banking and financial services (USD 672 million), and industry, mining and construction (USD 337 million). Altogether, they account for over 63% of the total volume mobilised on average in 2017–2018. In these sectors, it is relatively easier to identify revenue-generating projects that would attract private investors. They are followed by sectors such as transport and storage, agriculture, forestry and fishing, and communications, together accounting for 24% of the total. In contrast, sectors such as health, water and sanitation, education and other social sectors remain among the least targeted sectors. The data are also in line with findings of overall private sector engagement in projects funded by ODA, including modalities beyond blended finance.[7]

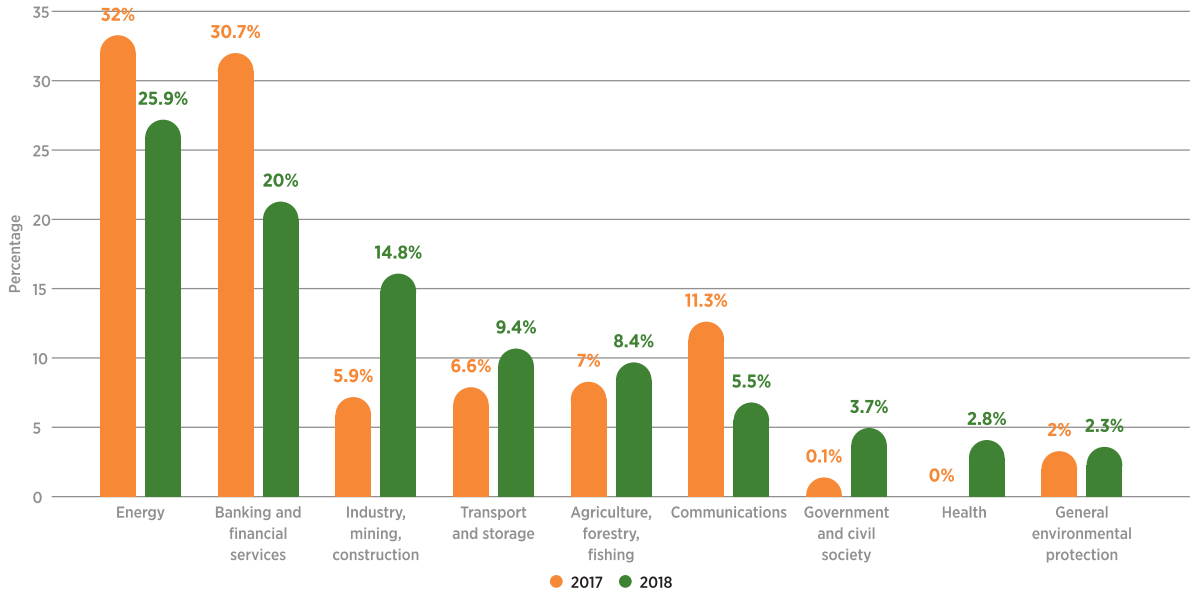
Figure 4.12. Private finance mobilised in LDCs by sector (average 2017–2018)



Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm.

However, as Figure 4.13 displays, the sectoral allocation of private finance mobilised in LDCs shows significant changes from year to year. This reflects the fluctuating nature of private finance more generally. In 2018, lower shares of private finance were mobilised in the energy, banking and financial services sectors, as well as in communications,[8] compared with 2017. In 2018 compared with 2017, a slightly higher proportion of private finance was mobilised in sectors such as industry, mining and construction, and transport and storage instead, as well as agriculture, government and civil society, health, and general environmental protection. Box 3.4 provides insights on a case study of a blended finance project in Bhutan focused on agriculture and Box 3.5 presents a case study on a water-related project financed through a blended finance approach in Uganda.

Figure 4.13. Private finance mobilised in LDCs by sector: 2017 versus 2018



Source: Authors, based on (OECD DAC, 2020[1]), Amounts mobilised from the private sector for development, http://www.oecd.org/development/stats/mobilisation.htm.

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Notes

[1] For 2012–2014, the IFC could provide data only on its commercial-terms mobilisation, including both private and official co-financiers. These data could therefore not be used for this analysis either.

[2] The OECD characterises fragility as the combination of exposure to risk and insufficient coping capacity of the state, systems and/or communities to manage, absorb or mitigate risks. Fragility can lead to negative outcomes, including violence, poverty, inequality, displacement, and environmental and political degradation (OECD, 2020[12]).

[3] This is the share of private finance mobilised on average in 2017–2018 against the average GDP in the same period. GDP data are from the World Bank World Development Indicators (World Bank, 2019[10]).

[4] See the timeline of the countries due to graduate from the LDC category at: https://www.un.org/development/desa/dpad/least-developed-country-category/ldc-graduation.html

[5] According to the 2018 report of the Committee for Development Policy of the United Nations Department of Economic and Social Affairs (UN, 2018[13]).

[6] This is also likely to be partially due to the improvement of the methodology and guidance for data reporting in 2019.

[7] A mapping of 919 private sector engagement projects in Bangladesh, Egypt, El Salvador and Uganda has found that the overwhelming majority of ODA-funded projects involving the private sector, included blended finance, occur in economic sectors, including banking and financial services (GPEDC, 2018[11]).

[8] The communications sector includes sub-sectors such as ICT, radio, television and print media, telecommunications and communications policy, and administrative management.

5. Blended finance in least developed countries in practice: guest contributions

This chapter presents a curated series of contributions provided by guest authors from a wide range of organisations: least developed country (LDC) partners, donors, multilateral development banks, private asset managers and investors, international organisations, consultancy companies and research centres. They focus on various topics related to blended finance in LDCs, namely country ownership, transparency, additionality and scalability, as well as specific thematic areas, such as digitalisation, urbanisation, local capital market development, “missing middle” challenges and national development banks.

5.1. Ensuring country ownership in blended finance: a perspective from Bangladesh

By Saber Hossain Chowdhury

Saber Hossain Chowdhury is Honorary President of the Inter-Parliamentary Union and Member of the Bangladeshi Parliament, representing Dhaka-9 constituency. He is a member of the Business Leaders Caucus of the Global Partnership for Effective Development Co-operation (GPEDC) and supported the development of the Kampala Principles on Effective Private Sector Engagement in Development Co-operation.

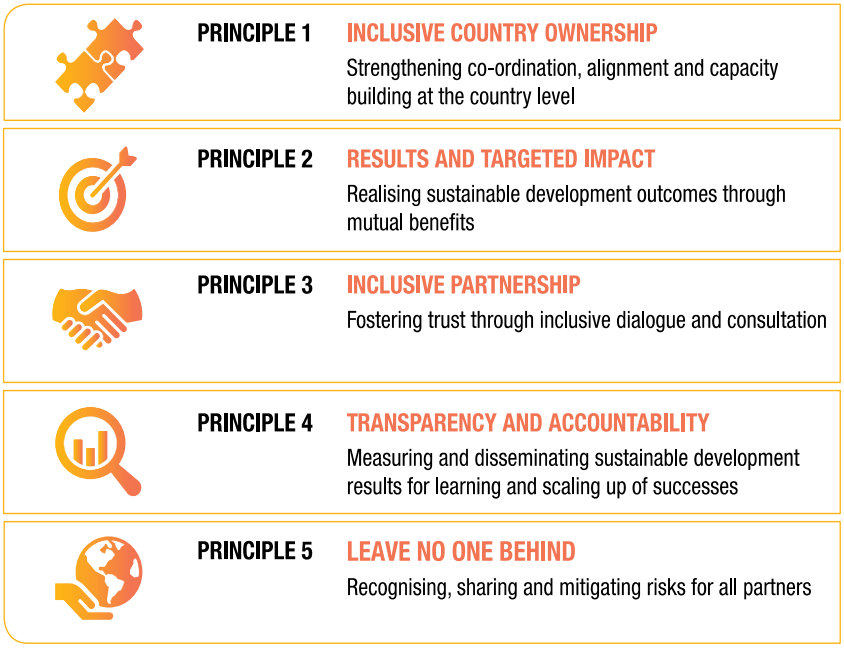
Bangladesh performed commendably in achieving the Millennium Development Goals and as an "early starter" country to implement the 2030 Agenda for Sustainable Development. Bangladesh prioritised the Sustainable Development Goals (SDGs) and integrated them into its seventh Five Year National Development Plan (2016–2020). Accordingly, this plan was aligned and harmonised with 14 SDGs and partially with three of them.

The SDGs have been embraced and mainstreamed in Bangladesh through an inter-ministerial committee to co-ordinate and facilitate the overall implementation and monitoring of the SDGs under the leadership of the Prime Minister's Office. Based on a comprehensive mapping of the SDGs, each ministry has been assigned targets that are being regularly monitored.

As the focus of the government's efforts is now firmly on SDG implementation, blended finance offers Bangladesh a strategic opportunity to mobilise additional resources by bridging the considerable SDG funding gap at a time when the availability of concessional financing for development is under threat. The SDG Financing Strategy formulated by the Government of Bangladesh stipulates that about 42% of total finance for attaining the SDGs will have to come from the private sector, and another 6% will need to be covered by public-private partnerships (Government of Bangladesh, 2017[1]).[1] Accordingly, the government attaches great importance to inclusive partnerships with the private sector as well as with development partners.

To ensure the sustainability of blended finance in Bangladesh, the terms of such finance should be calibrated and considered in a manner that minimises debt management challenges and debt servicing obligations, while at the same time ensuring that local financial markets are not undermined and market distortions are avoided (GPEDC, 2018[2]). A series of effectiveness considerations around private sector engagement, in particular blended finance, have been noted over the course of the past few years, and also informed the Kampala Principles of the Global Partnership for Effective Development Co-operation (see Figure 5.1).

Figure 5.1. Kampala Principles of the Global Partnership for Effective Development Co-operation



Source: (GPEDC, 2019[3]), Kampala Principles on Effective Private Sector Engagement in Development Co-operation, https://www.effectivecooperation.org/system/files/2019-07/Kampala%20Principles%20-%20final.pdf.

5.1.1. Lack of country ownership

Blended finance is applied globally, but there is no one size that fits all. Each investment has to take into account the local context and be tailored accordingly. However, to operationalise concept notes into successful ventures, there needs to be a clear understanding of the benefits of such investments and, just as importantly, the capacity to implement them.

Despite the identification of national priorities and the existence of an ambitious strategy, the Bangladesh experience demonstrates that there is greater scope for government participation.[2] Bangladesh could also improve its own capacity to implement the national strategy by increasing the array and combination of enabling policies and frameworks to ensure better co-ordination and delivery.

5.1.2. Targeting blended finance to MSMEs and leaving no one behind

Enterprises that ensure optimum national welfare, including the creation of decent jobs alongside sustainable business practices, should be prioritised, as they are severely constrained in terms of access to finance. Micro, small and medium-sized enterprises (MSMEs) account for 25% of Bangladesh's GDP, employing over 80% of the workforce (Bangladesh Bureau of Statistics, 2017[4]). Such MSMEs also have a catalytic role in setting up larger enterprises in the medium-term.

Accordingly, MSMEs are important beneficiaries of development co-operation and receive support in the form of access to finance, capacity development, value chain development and efforts to improve environmental, social and governance standards (GPEDC, 2018[2]). They do, however, require additional support to engage in business associations and take up opportunities for public-private dialogue.

Development partners should consider different approaches to support the engagement of MSMEs in blended finance, not only as beneficiaries, but also as partners in the design of projects. The use of local currency and investment in capacity-building with local financial institutions can help to unlock some

much-needed finance for MSMEs. Moreover, projects in which MSMEs are the final beneficiaries should be developed in close consultation with the organisations or associations representing them.

5.1.3. Mobilising blended finance in priority sectors: a case in point

It is noticeable that despite the opportunities and scope for investment in social infrastructure, blended finance projects in Bangladesh have been largely occurring in economic sectors. Blended finance can be leveraged to attract investment in areas and sectors critical for the attainment of SDGs.

Given the impact of COVID-19, there is the added imperative of engaging, incentivising and mobilising the private sector at a larger scale. In accordance with the "test, test, test" advice of the World Health Organization, and following the successful strategies of test, trace and treat from countries that have effectively responded to the global pandemic (such as the Republic of Korea), Bangladesh set up a multipurpose testing and triage booth (the first of its kind) for COVID-19 at the Mugda Hospital and Medical College, Dhaka. This novel initiative, as an immediate response to the global pandemic, was implemented by Digital Healthcare Solutions, a private healthcare provider, in collaboration with the Institute for Developing Science and Health Initiatives, a private foundation. The project was co-funded by UK Aid and implemented under the stewardship of the Ministry of Health and Family Welfare. Digital Healthcare Solutions and the ministry have contributed to the initiative both financially and in kind, including by providing the physical space, supervising and co-ordinating day-to-day activities and mobilising the local community. After successfully conducting over 8,000 tests and proving the concept, the venture has been handed over to the government. This collaboration has been an excellent and defining instance of all aspects of the Kampala Principles in action: country ownership, inclusive partnership, targeted impact, transparency and accountability, with an overall focus on benefiting the most vulnerable and those furthest behind.

This project, and the experience in Bangladesh, has shown that a harder look at the effectiveness of implementing blended finance projects (through the Kampala Principles) and mobilising additional private finance (through the Blended Finance Principles of the OECD DAC) will be critical to ensure blended finance can deliver better on the SDGs and for those furthest behind first.

5.2. The IFC's blended concessional finance for the most challenging markets

By Luigi Lannutti and Kruskaia Sierra-Escalante

Kruskaia Sierra-Escalante is the Senior Manager of the Blended Finance Department of the International Finance Corporation (IFC), managing blended concessional finance in the IFC across sectors and themes, including the International Development Association (IDA)'s Private Sector Window blended finance facility.

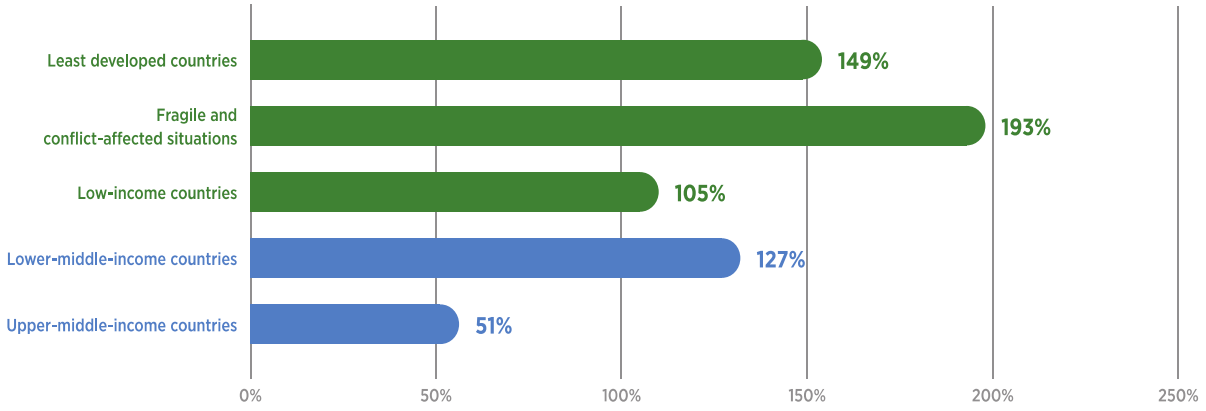
Luigi Lannutti is a Blended Finance Officer at the IFC, where he focuses on the enhancement of the strategic use of blended concessional finance in highly impactful transactions in risky and complex markets.

The IFC, a member of the World Bank Group, has committed to significantly growing its annual investments in the world's poorest and most fragile countries. In 2017, the IDA created the IDA Private Sector Window, a blended concessional finance[3] facility to help the World Bank Group to deliver more sustainable private sector investment in the world's poorest countries (OECD/UNCDF, 2019[5]).

5.2.1. A shift in IFC's blended finance activities

The introduction of IFC's new commitments – the IDA Private Sector Window and other blended finance facilities that focus on low-income countries, LDCs and fragile and conflict-affected situations (e.g. the Finland-IFC Blended Finance for Climate Facility, the Canada-IFC Renewable Energy for Africa Program) – **has influenced the trajectory of the IFC's blended finance activities.** As shown in Figure 5.2, the growth of the blended finance portfolio in the past four years has been faster in the most challenging markets, including low-income countries, LDCs and fragile and conflict-affected situations.[4] For example, the IFC's cumulative blended concessional finance co-investment commitments in LDCs stood at around USD 540 million at the end of the 2020 fiscal year (excluding regional programmes), 60% of which has materialised in the past three years, since the inception of the IDA Private Sector Window in 2017, with the remaining 40% having materialised in fiscal years of 2010–2017.

Figure 5.2. Growth of the IFC's blended finance cumulative commitment since the inception of the IDA's Private Sector Window



Note: Low-income, lower middle-income and upper middle-income countries follow the World Bank classification, fragile and conflict-affected situations follow IFC classification, and LDCs follow United Nations classification.
Note: This figure excludes world or regional programmes with no ex-ante attribution to specific countries. Such programmes include pooled first loss guarantees to support MSMEs across IDA Private Sector Window geographies, which are mostly low-income and lower middle-income countries, fragile and conflict-affected situations and LDCs. The inclusion of those programmes would show faster growth, in particular in fragile and conflict-affected situations and lower middle-income countries.
Source: Authors

The IFC's strategic focus and the availability of resources to support clients in the poorest countries have marked a more general shift in culture, which in turn is allowing the IFC to build new pipelines in the most challenging markets. Through these changes, the IFC is taking a more systematic approach to assessing the risks in low-income countries (LICs) and LDCs and designing targeted blended finance solutions.

5.2.2. Blended finance solutions in LICs and LDCs

A review of the IFC's blended finance investments reveals that some solutions are most effective at overcoming specific challenges and risks, especially in LICs and LDCs. While for projects in middle-income countries, limited concessionality may be enough, through either pricing or subordination, to make an innovative project happen and mobilise other financiers, in LICs and LDCs there is a need for more pronounced blending (higher concessionality,[5] multiple instruments, local currency solutions, etc.) to tackle overlapping layers of risk (weak or inexperienced sponsors, higher costs, lack of security, depth and breadth of capital markets). Solutions for investing in LICs and LDCs include the following.

- **Guarantees de-risk an investment by improving its credit profile.** For example, when operating through financial intermediaries, first-loss guarantees help to improve the credit profile of the financial intermediaries' underlying portfolios; the de-risked underlying portfolios can thus be expanded to underserved populations perceived to present a higher risk.
- **Subordinated financing can help to bridge a financing gap for a project** where there is not enough certainty of cash flows for senior lenders during the initial revenue ramp-up period, or in the case of limited available assets to offer as collateral.
- **Concessional local currency solutions allow the extension of long-term local currency loans** to offset asset-liability mismatches at terms that are viable for the project to proceed and/or for the end users to actually use the products or services (e.g., loans at tenors and terms that are viable for SMEs).
- **Investments in LICs and LDCs can require instruments that present higher concessionality levels.** For example, the IFC has observed that guarantees and local currency solutions often embed a grant element that is higher than that of other products.[6]
- **Multilayer approaches should be designed when several risks need to be tackled at the same time.** For example, the risk due to unavailability of collateral is a participation constraint that in an LDC often coexists with a lack of affordable long-term local currency.
- **Less leverage of blended finance instruments is expected in LICs and LDCs**, because it is harder to mobilise commercial investors. The overall leverage of the IFC's blended finance facilities of USD 1 of concessional funds to USD 8 of total project cost drops to a 1-in-4 ratio for projects in LICs and LDCs.
- **The use of blended finance in tandem with public reforms and capacity-building is a must in new and/or underdeveloped markets.** For example, it is important to accompany local currency loans with solutions that support the development of the local capital markets, to sustain the commercial viability of future investments; in this context, the IFC strives to use local currency loans in combination with local currency bonds as part of a holistic capital market transformation process. Technical assistance programmes are equally important.

Regardless of where and how blending is implemented, it is imperative to have rigorous governance,[7] clear principles[8] and disclosure practices[9] for an efficient, effective and transparent use of blended concessional finance.

5.2.3. Development impact and COVID-19 solutions

The use of blended finance requires a strong development rationale. The IFC's Anticipated Impact Measurement and Monitoring (AIMM) system enables the IFC to estimate the expected development impact of its investments. The AIMM system also allows the IFC to examine a project's systemic effects on the overall market. This is particularly important when using blended finance in LICs and LDCs, where the objective is to create a new market by using concessional finance only temporarily to help to introduce fully commercial finance over time.

The scores on the AIMM system for projects supported by blended finance are on average higher than for projects that do not use blended finance, and this is even clearer when looking at projects supported by blended finance in the most challenging markets eligible for IDA Private Sector Window resources. First movers' transactions in LIC and LDC markets have a stronger potential for market creation (often through demonstration effects), although their probability of success may be lower due to the local market challenges.

Market failures and risks in LICs and LDCs may be exacerbated by the COVID-19 crisis. Risk perception is heightened in these countries where governments may have lower capacity to respond. Blended finance is a critical instrument for the IFC's response. Up to USD 400 million of IDA Private Sector

Window resources are supporting the expansion of the IFC's global trade finance programme (GTFP) in IDA Private Sector Window countries[10] to fill a trade-financing gap that is now widening because of COVID-19. An additional USD 80 million of IDA Private Sector Window resources have been made available to provide de-risking solutions to the IFC's real sector crisis response, which works with IFC's clients in industries vulnerable to the pandemic, including infrastructure, manufacturing, agriculture and services. Up to an additional USD 216.1 million of IDA Private Sector Window resources support the IFC's Working Capital Solutions facility to expand working capital loans in IDA Private Sector Window countries by de-risking these loans through a first loss guarantee. Other blended finance solutions[11] have been designed along with the IDA Private Sector Window to support on-lending from Working Capital Solutions to women-owned and women-led enterprises. In recent years, blended finance has been used to help open new markets and extend development impact; in this period of extreme uncertainty, blended finance can help the IFC to support its clients' continued economic activity, ensuring that the progress to date is not erased and that these businesses will emerge in good standing on the other side of the crisis.

5.3. An efficient and scalable approach for blended finance, focused on least developed countries

By Aakif Merchant

Aakif Merchant is the Manager of Training and Engagement at Convergence Blended Finance, where he supports investors to execute blended finance transactions that increase private sector investment in emerging markets.

As we enter the decade of action to realise the SDGs, the United Nations Secretary-General António Guterres declared that LDCs will face the gravest battle to achieve sustainable development, in large part due to the annual SDG funding gap across LDCs, which is USD 400 billion, according to the United Nations Sustainable Development Solutions Network (SDSN, 2019[6]).

This staggering figure shrinks in significance in the global context; it amounts to 0.5% of global GDP, 2% of global annual savings and 0.2% of global capital markets. The only way to unlock more existing finance to advance the SDGs in LDCs is to mobilise private finance in greater volume.

The adoption of the Addis Abba Action Agenda in 2015 encouraged the global development community to explore additional ways to draw expertise and resources from the private sector to increase investment in projects targeting SDGs, to supplement official development assistance (ODA). In doing so, numerous barriers were identified that are preventing capital flows into frontier and emerging markets, including high perceived and real risks, and poor returns that are not commensurate the risks.

An efficient and scalable approach to overcome some of these challenges exists, and that is blended finance. Blended finance, a structuring approach, can bring risk-adjusted returns in line with private investors' requirements, by shifting risks and/or managing returns. As referenced in this report, and confirmed by data from Convergence's historical deals database, only a small percentage of blended finance flows reaches LDCs. As blended finance enters the mainstream, we need to ask ourselves how this approach can be further leveraged to mobilise much-needed resources for the LDCs.

Private investors face several challenges when investing in LDCs, but one is particularly acute – individual investment opportunities that are often too small for the private sector.

Blended finance can support transactions at one of two levels: the project/company level or the portfolio level (e.g. pooled fund or facility). **To get around the barrier cited above, within LDCs, portfolio**

approaches can be more effective in mobilising private investment at large scale, for the following reasons.

- **They increase the ticket/deal size.** Private investors often look for large investment sizes (e.g. USD 10–15 million) but few projects or companies in LDCs have sufficient stand-alone scale to warrant a sizeable investment. Aggregating multiple projects (e.g. through a portfolio or syndication approach) can therefore achieve the required critical mass.
- **They merit the long approval cycles and high appraisal costs.** ODA providers such as development agencies have long project approval cycles, regardless of project size. Additionally, investors often find one-off deals to be too costly to appraise. Investors thus believe it is worth undergoing the long approval cycle and high appraisal costs for large deals, which, for SDG-targeted development projects in LDCs, can be achieved only on a portfolio basis.
- **They create diversification to reduce risk-return variance.** Diversification across projects reduces risk-return variance for investors. The big three ratings agencies follow a methodology that allows for a two-notch upgrade for diversification across multiple borrowers in non-investment grade countries. Convergence's analysis shows that countries rated in the LDC cohort have a median long-term sovereign rating of "B", so a portfolio of B-rated projects can be enhanced to BB simply through a portfolio diversification approach. In LDCs, which have a high level of real and perceived risk, diversification across multiple companies/projects or sectors can be highly beneficial. Diversification across LDC countries also needs to be considered. Though Convergence's data show a concentration of blended transactions across Rwanda, Tanzania and Uganda, we have observed in recent years blended finance activity expanding to new LDCs such as Cambodia, Madagascar and Mali.

Given these reasons, it is indeed no surprise that a plurality (41%) of LDC-focused blended finance transactions in Convergence database represent portfolio approaches to blending, although this number has decreased over time. Development funders should prioritise a portfolio approach along with asymmetrical risk-return profiles to mobilise private investors. The problems facing LDCs are formidable, and solving them will require significantly more financial resources to flow into projects and transactions in these countries. The approach articulated here will help to draw in additional sources of finance and bring us closer to closing the SDG funding gap in countries with the most challenging environments.

5.4. Providing additionality through investment in different commercial scenarios

By Pooja Yadav and Nathan Kelly

Pooja Yadav is an Associate Principal at the CrossBoundary Group, where she provides investment advisory services, and specialised expertise in unlocking investment across all sectors in fragile and frontier markets.

Nathan Kelly is a Senior Associate at the CrossBoundary Group, where he is involved in the structuring of CrossBoundary's investment facilitation platforms and providing transaction support in frontier markets.

CrossBoundary manages two blended finance vehicles that invest in renewable energy in sub-Saharan Africa – one investing in single off-taker, commercial and industrial solar systems, and the other investing in rural solar-powered mini-grids. Both these vehicles use donor capital to unlock private investment into high-risk sectors and geographies. While the literature on blended finance often emphasises the ability to create leverage with limited donor capital, the economic implications of COVID-19 reinforce the importance of also providing additionality to create resilient ecosystems, particularly for more

vulnerable population segments. Examining both vehicles as case studies provides a useful framework for donors to consider how to use their limited capital to create both private sector leverage and additionality.

Demand for donor capital in blended finance vehicles has never been higher. But when it comes to blended finance vehicles, comparing the impact of donor capital in one vehicle versus another is not always straightforward. Some vehicles will boast very high leverage on donor capital (i.e. the amount of private capital attracted for every dollar of donor capital), while others will pursue higher-risk, lower-return opportunities where donor capital may be more additional (i.e. creating positive externalities that could not otherwise be addressed through commercial capital) but will attract less commercial capital. Understanding and comparing the amount of leverage and additionality each vehicle brings can help donors to compare the impact of blended finance opportunities more precisely, ultimately allowing them to make better decisions with their limited capital.

5.4.1. Donor capital use case 1: de-risk investment into a commercially viable – yet unproven – asset class

Challenge: Throughout sub-Saharan Africa, businesses face high electricity costs and low reliability. This critical – yet systematically underfinanced – development gap challenges the growth potential for many of the continent's enterprises. It can also have significant environmental implications. Despite emerging solar technology, which offers cheaper, cleaner and more reliable power, many businesses continue to rely on backup diesel generation due to high upfront costs for solar installations and limited access to finance.

Opportunity: In response to this challenge, CrossBoundary launched CrossBoundary Energy (CBE), the first investment vehicle focused on commercial and industrial solar in Africa. CBE aggregates a portfolio of long-term power purchase agreements with enterprises in Africa. This structure allows investors to access a new commercial asset class with the potential for significant environmental and economic impact.

Donor role: The pilot fund launched in 2015 with an innovative two-tier equity capital structure, anchored on USD 1.3 million of first-of-its-kind first-loss capital from the United States Agency for International Development (USAID). By taking a subordinate position to other investors' initial investments, this donor commitment provided more risk-averse investors with greater protection and increased their incentive to invest. First-loss capital can provide a critical de-risking mechanism for private investors who may recognise potential for commercial and developmental returns but are discouraged by the risk of a new sector or asset class. The blended finance structure allowed the fund to raise an additional USD 30 million from public and private institutions; it is ultimately expected to mobilise well over USD 100 million. Today, CBE is Africa's largest utility for enterprise solar, supplying the continent's leading brands with reliable and affordable electricity.

5.4.2. Donor capital use case 2: attract investment into a non-commercially viable – yet developmentally critical – asset class

Challenge: Mini-grids are the most economical solution for providing access to energy to 100 million of the 600 million people without electricity in Africa (Tilleard, Davies and Shaw, 2018[7]). Still, rural mini-grids have struggled to scale up due to a lack of necessary co-ordination between investors, developers and development actors to solve the three core barriers to investment:

- mini-grid companies develop, construct and own mini-grids, but very few investors are able to fund all three activities
- mini-grids are small, with ticket sizes well below typical investor thresholds
- mini-grids target rural customers in developing economies who are typically costly to connect and have low spending power. As such, the initial profitability is low, and the ultimate profitability is unknown.

Opportunity: CrossBoundary Energy Access is a blended project finance facility, the first of its kind dedicated to financing mini-grid projects in Africa, currently with investments in Tanzania. The fund aggregates mini-grid assets into special purpose vehicles – sizeable enough to attract institutional investment – and uses concessional capital to bridge the profitability gap. The fund also tests models to reduce risk (such as pay-as-you-go models) and to increase profitability (such as appliance financing schemes).

Donor role: Thanks to concessional capital from the Rockefeller Foundation, the USD 18 million pilot fund successfully raised equity from private investors and debt from development finance institutions (DFIs), allowing investors to finance just the mini-grid assets (insulating them from the development, construction and customer acquisition risk that they would face by investing directly into the developer) and subsequently receive inflation-linked returns over a 10- to 20-year period.

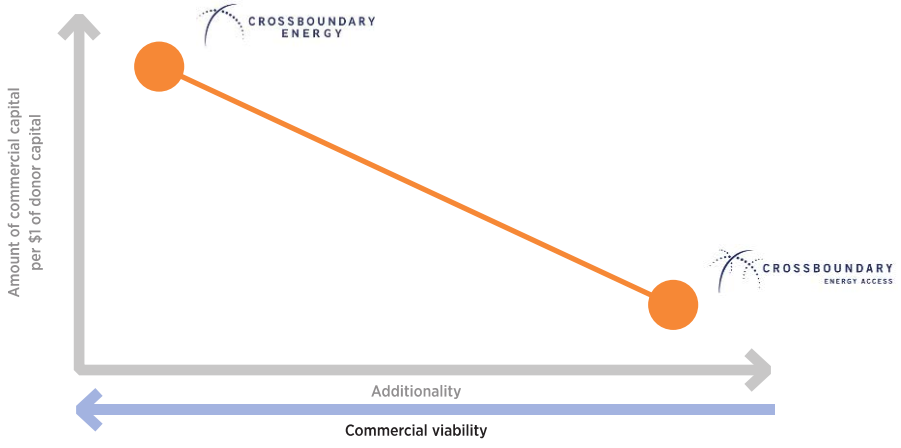
In this example, where the underlying assets require a subsidy to achieve commercial returns, blended finance can be used to unlock additional capital to achieve even greater impact outcomes. If the fund proves successful, it has the potential to unlock access to a trillion-dollar infrastructure capital market and bring electricity to millions of people across Africa.

5.4.3. Donors should evaluate the commercial viability of the underlying investment in a blended finance vehicle and weigh it against the development impact they want to achieve

For blended finance vehicles that address unproven markets but are forecasted to be commercially viable, donor capital can unlock a sector through simple risk mitigation, ultimately attracting large volumes of commercial capital for every dollar of donor capital.

For blended finance vehicles that address an asset class that is not forecasted to be commercially viable initially, donor capital will attract less commercial capital for every dollar of donor capital spent. However, these investments tend to achieve greater additionality (Figure 5.3). For donors in LDCs, understanding the commercial viability of the underlying investment will help to weigh one opportunity fairly against another in a way that relying on leverage or additionality alone will not do.

Figure 5.3. Commercial viability versus development impact



Source: Authors

5.5. Four ways to refresh blended finance in the wake of coronavirus (COVID-19)

By Feisal Hussain

Feisal Hussain is the Managing Director of ThinkAhead Consulting, where he specialises in innovation and blended finance.

Blended finance perfectly captures the zeitgeist of the millennial generation, bringing together in harmony seemingly contrasting characteristics of conscious capitalism and pragmatic idealism. However, the COVID-19 pandemic has exposed the fault lines that were already evident before the pandemic, while also revealing new ones. Blended finance providers need to make a case for why, in the context of extreme fiscal pressures and bare markets, blended finance offers stronger long-term prospects to help build the economy back better. However, in doing so, they need to avoid merely rehashing the traditional business case for blended finance, and show how they will change blended finance's priorities and approaches as a consequence of COVID-19.

5.5.1. Building up resilient systems

The success of blended finance should be measured not simply in terms of the scale of investment triggered and the amount of private finance mobilised. More emphasis should be placed on how well blended finance has contributed to market systems that are more inclusive, sustainable and resilient, and how well it has enabled large-scale and sustainable growth in private investment.

As the world recovers from COVID-19, the blended finance community will need to ensure that every investment contributes to creating systems resilience. This means prioritising blended finance investments in, for example, health systems, research and development, and natural ecosystems that can help to regenerate local economies, while also requiring every investment, irrespective of sector, to integrate digital systems to enhance transparency and reduce risk and transaction costs. This will also improve the predictive and response capability of the systems as a whole.

5.5.2. Being responsible and thoughtful actors

The application of blended finance must be promoted responsibly and with caution, ensuring that it does not deliberately compete for public and non-commercial resources in areas that carry no private returns but generate very high socio-economic returns. Moreover, a push for blended finance should not eclipse the need for grants or divert public subsidy away from interventions that boost local investment environments.

There is reason to approach this cautiously because the unintended consequences of pushing blended finance may be to create perverse outcomes. It is important to recognise that distributional inequities in blended finance are symptoms of deeper binding constraints on commercial investment decisions. Typically, these are where the investment climate is challenging (e.g. complex regulatory requirements or corruption), markets are not functioning and the risk-adjusted rate of return is uncompetitive. For example, the Overseas Development Institute (ODI) estimates that more than 96% of private finance mobilised through blended finance goes to countries with a credit rating, which most LDCs do not have or fare badly in (ODI, 2019[8]). Under such circumstances, concessional finance may tip the balance, but will not work or sustain its effects if the economic fundamentals are not in place.

5.5.3. Opening up the gated community

The blended finance community must break free of its dominant public sector character and must include the diverse range of providers that make up the blended finance ecosystem. The blended finance universe has found itself confined to a gated community of members drawn from the traditional world of bilateral DFIs and multilateral development banks (MDBs). Today, this traditional club of providers is complemented by the growth of other forms of financing, including from the non-DAC countries, impact investors and philanthropists, as well as private individuals who are taking advantage of digital platforms to invest directly into enterprises and projects that would have been unthinkable and prohibitively expensive a decade or two ago. Taken together, these new financiers deliver more capital to developing countries and leverage more commercial capital than traditional purveyors of blended finance. Consider the following facts.

- According to the DFI Working Group on Blended Concessional Finance for Private Sector Projects, DFIs and MDBs mobilised USD 1.7 billion from the private sector in 2018 by blending USD 1.1 billion in concessional funds with USD 2.4 billion of DFI own-account investments (DFI Working Group, 2019[9]).
- According to Giving USA, American philanthropic foundations managed about USD 950 billion in their endowments, and invested roughly USD 75 billion in 2019 (Giving USA, 2019[10]).
- According to Global Impact Investing Network, its impact investor members collectively manage over USD 400 billion in assets, and in 2019 invested USD 47 billion with a compound annual growth rate of 17% (GIIN, 2019[11]).
- According to Statista, alternative lending platforms in emerging and developing economies, including crowd lending (i.e. digital lending to SMEs) and peer-to-peer lending (i.e. digital lending to individuals), channelled USD 225 billion in 2019 with a compound annual growth rate of over 50%. Excluding China and India, the alternative lending market channelled more than USD 2.4 billion to businesses and individuals in developing and emerging markets, leveraging capital from the private sector at roughly the same level as traditional blended finance providers (Statista, 2020[12]).

The gates of the blended finance community, therefore, need to be opened to these new players, to new approaches and platforms, and to new forms of collaboration based on comparative advantage.

5.5.4. Creating strategic convergence and synergy

The artificial distinction between grant and non-grant instruments must change post-COVID-19. Blended finance as implemented by DFIs and MDBs has become synonymous with the use of non-grant instruments. Yet if financial leverage is the metric by which blended finance is judged, there is a distinction without a difference between grant and non-grant instruments vis-à-vis their blended finance capabilities. According to the ODI, MDBs and DFIs contributed just under 60% of the cost of blended finance investments overall and as much as 73% in LDCs. On the other hand, bilateral grant providers mobilise more private finance in LDCs than MDBs, relative to their contribution.

Besides value for money and leverage, the differences in approach between grant-giving institutions and non-grant-giving DFIs and MDBs are narrowing. Grant providers have been gradually honing approaches and tools that increase private sector investment. This is especially true in LDCs, where risk levels are high and private investors require a greater degree of risk mitigation. Grant providers have tested and scaled up approaches that create conditions for greater private sector investment (e.g. investment climate assessments, financial sector development, assistance for capital market development, etc.). They have also tested and scaled up tools that work directly with the private sector to trigger investment using both non-financial instruments (e.g. market systems approaches to private sector development, start-up incubators, etc.) and financial tools (e.g. challenge funds).

Notwithstanding greater convergence, non-grant and grant providers have distinctive incentives and philosophies. Non-grant agencies are instinctively risk-averse, given the pressures to retain the value of their capital or AAA rating. Consequently, they are unlikely to significantly increase their exposure in LDCs any time soon. On the other hand, grant providers have none of the commercial pressures faced by DFIs and MDBs and thus can take greater risks, especially in LDCs.

Post-COVID-19 blended finance arrangements will, therefore, need more joint approaches between grant providers and non-grant providers, leveraging each other's comparative advantages, tools and instruments to maximise both financial leverage and larger impact. As the world convulses in response to COVID-19, so too does blended finance. While this poses some immediate risks, the pandemic also presents opportunities to improve and reform blended finance, allowing the system to build forward better.

5.6. Taking blended finance to large scale by developing market systems

By Roland V Pearson Junior

Roland V Pearson Junior is the Executive Director of USAID CATALYZE, implemented by Palladium, where he is also a Director for Innovative Finance in the Economic Growth and Governance practice.

Blended finance continues to grow apace. Data from Convergence and the OECD/UNCDF show average annual growth rates of around 20% over the past five to ten years in both the amount of capital mobilised and the number of deals done across all sectors and country types.[12] We continue to see innovations introduced among transactions at the enterprise, institution and fund levels. New structures and approaches have begun to address a more robust set of risks.

Nonetheless, several impediments continue to stymie the potential growth and impact of blended finance, such as asymmetric information, country risk, volatile foreign exchange risk, poor governance, and enterprise-level risks. In particular, frontier markets (or LDCs) and social sectors such as health and education continue to attract the tiniest proportions of global capital mobilised. Market friction presents another major barrier to the growth and sustainability of blended finance – as evidenced by the expense, complexity and over-reliance on experts from the global North. The preponderance of debt among blended finance transactions reflects market demand and supply-side limitations. However, in the absence of equity and other non-debt and longer-term instruments, enterprises face the risk of over-leverage, which will limit their ability to grow and to contribute to increases in national and household incomes, as well as job creation. To scale up and achieve more systemic impact, blended finance will need to incorporate more equity and other sophisticated instruments.

The COVID-19 crisis has shed glaring light on the insufficiency of the ecosystems of key actors and enabling policies, structures and capabilities, which mutes the potential of blended finance. The lack of local capital market integration, the poor capacity of intermediaries to connect enterprises with emergency sources of funding, and an absence of blended finance vehicles that work in the aggregate (e.g. standby facilities that would trigger guaranteed government bond issues in a crisis) are only a few of the shortcomings in current markets. Concurrently, COVID-19 does offer an opportunity to broaden the frame to look at blended finance through a risk/resilience lens. For blended finance to have sustained relevance, especially in LDCs, it must be able to respond in a systemic way to systemic crises. Blended finance must yield scope and scale that go beyond individual actors, and over periods of time that extend well beyond "normal" transactional time frames, not just in response to COVID-19, but also climate change, recurring natural disasters and persistent threats of unrest.

Beyond building the facilities for blended finance to operate well at systemic levels, a market development approach also addresses specific LDC issues. Many LDCs tend to be smaller economies

where transaction costs can be inordinately high. LDCs also often lack a sufficient mass of players and prospects, while at the same time suffering from underdeveloped financial and capital markets.

In recognition of these market deficiencies, Palladium has designed a blended finance market development approach that focuses on building a key component of that ecosystem, namely, a transaction advisory and business development advisers. Our approach generates blended finance transactions, by using donor grants to fund paid-for results incentives for the advisers to close deals between financial institutions and designated demand-side clients (agro-processors, educational institutions, health services providers, women-owned enterprises, etc.). Meanwhile, we also provide training, mentorship, technical assistance and other forms of capacity building support to those advisers. We also look to embed long-term market viability and capacity support by connecting advisers to local and regional training and other institutions, facilitating connections among advisers and other key market actors.

Under the USAID-funded, eight-year CATALYZE programme, which began in October 2019, **Palladium has a mandate to work globally in any sector, with a keen focus on frontier markets and social sectors.** Under CATALYZE, we will apply our market development model in places like the Democratic Republic of the Congo, Ethiopia, the Sahel and Zambia, while also achieving improved development outcomes across issues as diverse as early childhood development, primary education, women's labour force participation, and youth entrepreneurship in multiple agricultural value chains.

Although we have yet to see enough activity in our start-up phase to offer performance data, **we do see potential to catalyse blended capital and foment market development through our interventions.** For example, by leveraging the attention brought by COVID-19 and applying a risk and resilience lens to many investment theses, we have begun to see investor interest in post-harvest loss interventions (e.g. storage, refrigeration, etc.) for agriculture, or the building of manufacturing capabilities to meet local demand with local supply. Meanwhile, additional players are being introduced to the education field, by positioning investments as opportunities to leverage digital technologies for myriad development objectives, including to facilitate remote learning.

Across geographies and sectors, Palladium will create and promote a community of action, composed of investors, enterprises and innovators, as well as a coterie of intermediaries, thought leaders and other market actors. Facilitating transactions will result in the achievement of our USD 2 billion capital mobilisation target. More importantly, that activity will serve as both an impetus for, and a demonstration of, market development.

5.7. How the digital revolution is transforming blended finance solutions that reach the last mile

By Henri Dommel

Henri Dommel is the Director of UNCDF's Financial Inclusion practice, where he is responsible for leading the unit's strategy in promoting digital finance and the development of inclusive digital economies in LDCs.

The COVID-19 crisis has further increased the massive financing gap LDCs are facing to achieve the SDGs by 2030. A major disrupter and potential accelerator in attracting private capital is the digital finance revolution, which is transforming how private finance can be sourced, mobilised, deployed and monitored in ways that can reach the last mile and that were unthinkable just a decade ago.

Over the past ten years, the digital revolution has not only transformed how people access and use financial services, but has also enabled the growing integration of finance with the "real economy" in such areas as clean energy, agriculture, entrepreneurship, and health and education (UN, 2020[13]). This disruption has created rapid growth for a wide range of SMEs, and business models that can leverage blended finance solutions to reach large scale. For example, energy service companies that use digital pay-go solutions have become a new and rapidly growing asset class for blended finance investors. In LDCs, energy service companies have become some of the major recipients of on-balance-sheet concessional lending, enabling follow-on investment by domestic financial institutions or international impact investors.

Digital technologies have also profoundly transformed options to mobilise finance and align its deployment with the SDGs, as highlighted in the report of the United Nations Task Force on Digital Financing of the SDGs (UN, 2020[13]). Innovations in agent banking and alternative delivery channels have made it possible to mobilise and channel informal savings at large scale into the formal financial system. Digital technology can facilitate the reinvestment of those savings into long-term investments in priority socio-economic infrastructure (roads, schools, health centres, etc.) and localise those investments in districts where individual savers will directly benefit from improved services and from receiving financial dividends. The digital finance revolution is also disrupting and expanding how blended finance solutions can be deployed to contribute to the financing of the SDGs. It is doing so by transforming the potential for domestic resource mobilisation and for citizens to have a voice in how their savings are invested, or by expanding blended finance solutions to SMEs on a scale that was unthinkable before. This emerging generation of blended finance solutions rests on an innovative use of data that enables new models of resource mobilisation (even from very small individual savings) and their aggregation to finance a wide range of economic priorities, from socio-economic infrastructure to women-led MSMEs, supported by de-risking instruments and donor-funded technical assistance.

The feasibility of using digital savings for reinvestments by local and national governments in key socio-economic infrastructures is being tested by a2i[13] in partnership with UNCDF as one of the pathfinder projects of the United Nations Task Force on Digital Financing of the SDGs. Pre-COVID-19, it was forecasted that, in 2020, savings by Bangladeshi citizens totalling USD 118.4 billion could be tapped to finance the SDGs (including USD 61 billion formal savings, USD 41 billion informal savings, USD 14 billion from remittances flows, and USD 2.4 billion zakat funds) (LightCastle Partners, forthcoming[14]); (McKinsey Global Institute, 2016[15]).[14] Digital finance offers the potential to transform Bangladeshi citizens from micro-savers to micro-investors, enabling the aggregation of those savings at very low cost, with the requisite guarantee and liquidity mechanisms built into investment instruments that could fund the socio-economic infrastructure that would directly improve their lives. The infrastructure budget in Bangladesh for the fiscal year 2019–2020 stood at USD 24 billion, 48% of which was financed through external sources (LightCastle Partners, forthcoming[14]);[15] this is expected to grow substantially by 2030 due to funding requirements to meet the SDGs. Harnessing domestic savings could help both to lower the dependence on external debt and to strengthen Bangladeshi citizens' stakes in and ownership of those investments. More generally, connecting national SDG priorities and digital financing opportunities offers a tremendous scope for growth and is an area currently being advanced by UNCDF. The deployment of this type of solution calls for blended finance models that include sovereign guarantees to protect the integrity of those citizens' savings or de-risk those infrastructure investments.

Digital finance is also accelerating the formalisation of remittance flows, which can directly benefit migrants and their families, not only through lower fees, but also by creating a financial transaction history that can facilitate access to other financial services, especially loans. Blended finance models can be deployed to further support the reinvestment of remittances in priority sectors, with a government or third-party guarantee. In Nepal, UNCDF supported a partnership between Al Fardan Exchange in the United Arab Emirates and Laxmi Bank to test a new use case to securitise remittance flows to extend un-

collateralised credit based on the remittance transaction history and other alternative data sources, using a blockchain lending platform.

Digital innovations are also transforming blended finance models for MSME access to capital markets. In the context of the United Nations Task Force on Digital Financing of the SDGs, EcoCash and Financial Securities Exchange (FINSEC), with support from the Investors Exchange (IEX), the Food and Agriculture Organization of the United Nations and UNCDF, have set up an MSME investment platform (GEM Portal) in Zimbabwe linked to FINSEC that leverages alternative data generated from the major mobile money operator in the country and banks, to create investment profiles and bridge the long-term financing gap between high-potential MSME and investors.[16] This platform will offer a new venue for investors, banks and venture capitalists to invest in MSMEs in Zimbabwe in a totally new way. With non-traditional and digital mechanisms of enterprise assessment implemented through this platform, the role of DFIs in this initiative to catalyse and unlock private capital to be invested becomes important, by deploying guarantee instruments and concessional capital.

In addition to improving risk pricing, the exponential growth in data gathering and processing that is enabled by the digital revolution has helped to increase both the alignment with the SDGs and the impact monitoring of blended finance investment decisions. Digital platforms such as the Future of Sustainable Data Alliance are advancing data-driven approaches to the effective integration of environmental, social and governance factors into decision making processes, and greater incorporation of SDG-related risks and impacts in financing decisions. In that respect, the digital revolution also holds the potential to help further align blended finance deployments to the SDGs.

5.8. Cities and blended finance in the aftermath of coronavirus (COVID-19)

By David Jackson and Nan Zhang

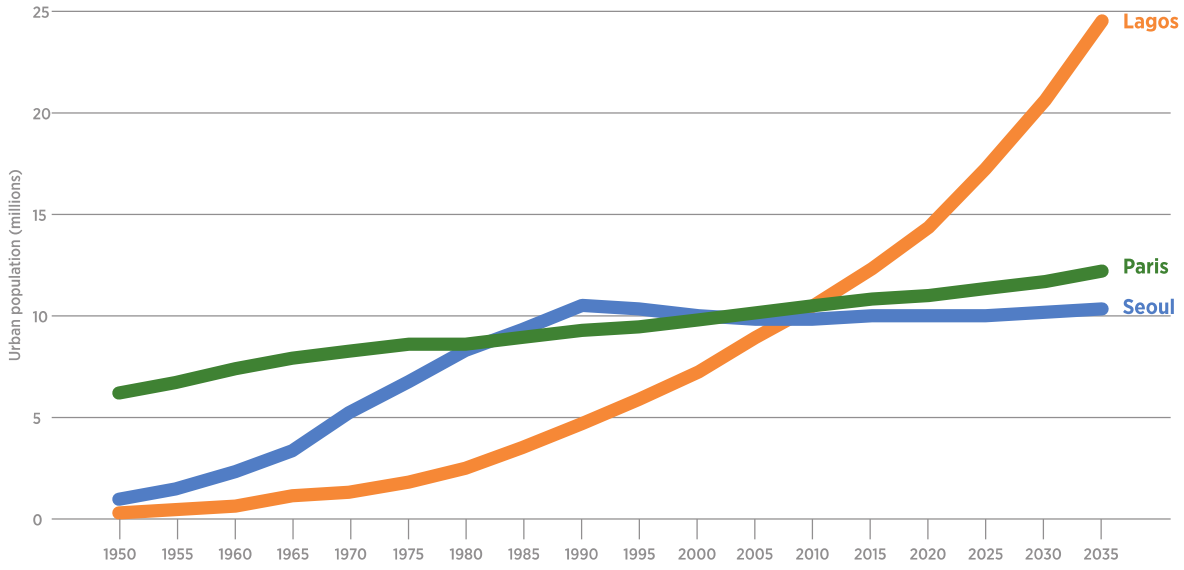
David Jackson is the Director of UNCDF's Local Development Finance practice, where he manages and leads the substantive development of a portfolio of local development programmes and projects that leverage increases in local capital formation and local fiscal space in LDCs.

Nan Zhang is a Programme Analyst at UNCDF, where she supports global projects in municipal finance, urban infrastructure, and climate change adaptation.

5.8.1. Problem: the existential dilemma of urbanisation finance

On the 75th anniversary of the United Nations it is useful to reflect on the changed demographics of the world and the financial arrangements and institutions that are now required. At the birth of the United Nations, less than a third of people lived in urban areas. By 2010, we reached a 50/50 share. Today, around two thirds of us live in towns and cities (UNCDF, 2020[16]). This change is happening at an accelerating rate (see Figure 5.4). It took Paris over 100 years to grow from half a million to a million inhabitants. Asian cities in the mid-20th century required 50 years. Lagos needed only ten years, from 1955 to 1965. Currently, African cities are making this transition at even more rapid rates.[17]

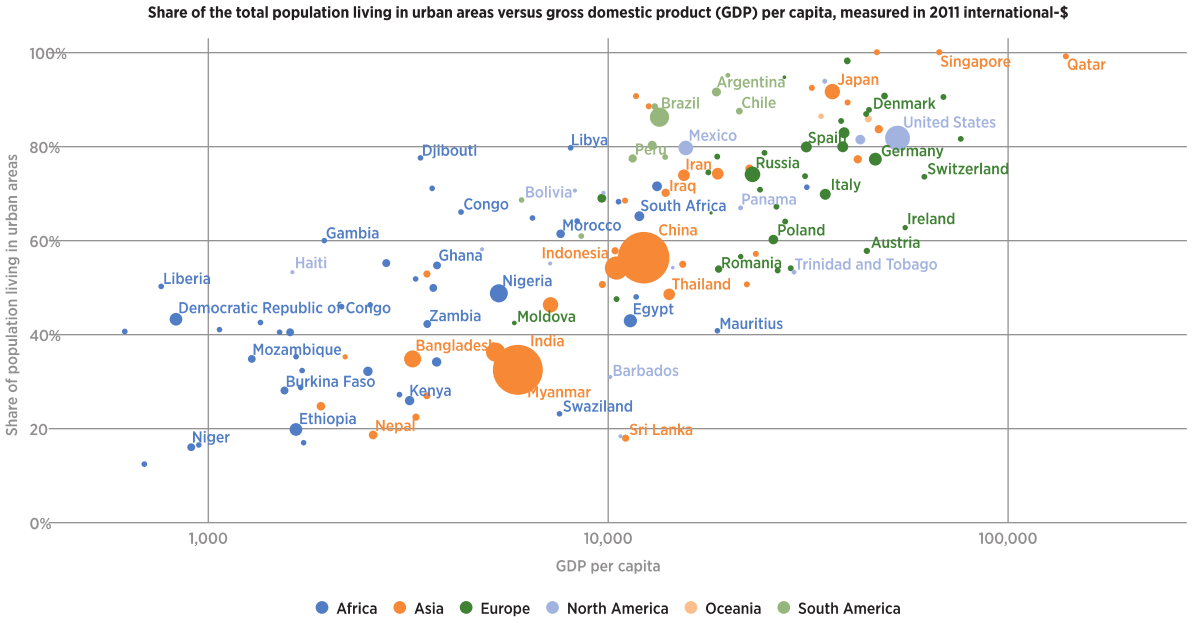
Figure 5.4. Urbanisation growth in Lagos, Paris and Seoul



Source: (UN, 2018[17]), World Urbanization Prospects: The 2018 Revision. Annual Population of Urban Agglomerations with 300,000 or more in 2018 (thousands), https://population.un.org/wup/DataQuery/.

The world is also a much richer place than it was 75 years ago – and a more unequal one. In sub-Saharan Africa, the urban population increased from 22% in 1980 to over 40% in 2018, and total GDP surged from USD 271 billion to USD 1.7 trillion (World Bank, 2019[18]). Globally, urbanisation and GDP growth have risen hand in hand (Figure 5.5) and there seems to be a correlation between urbanisation and increases in productivity (EIB, 2020[19]).

Figure 5.5. Urban population versus GDP per capita, 2016



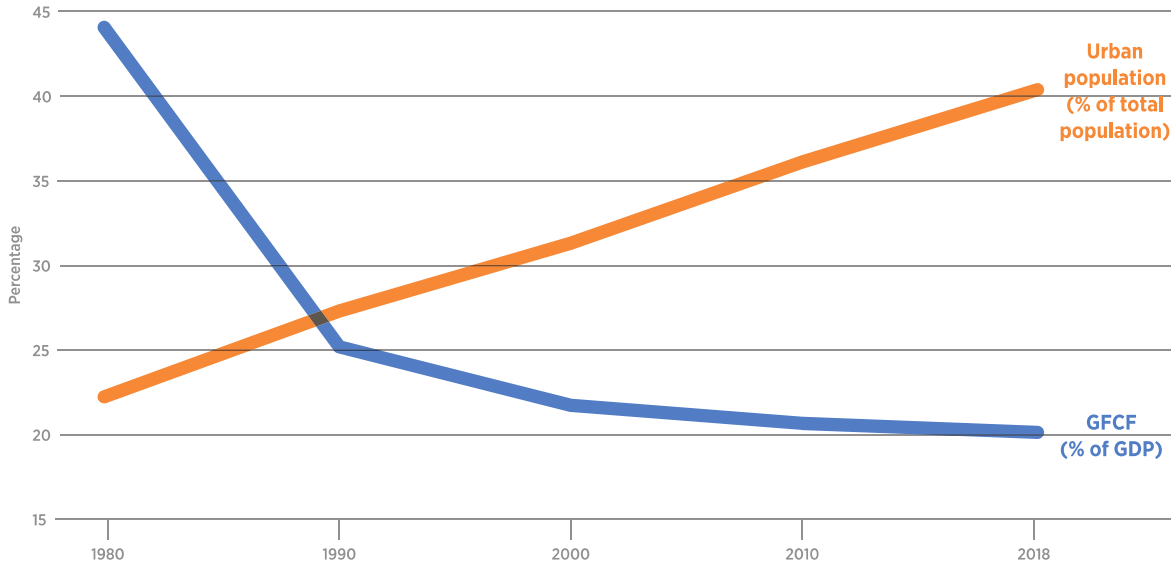
Source: (Our World in Data, 2016[20]), https://ourworldindata.org/grapher/urbanization-vs-gdp.

This correlation, however, is not automatic. A closer look at the global data on GDP over time reveals that gross fixed capital formation (GFCF) has remained at about 25% of GDP since 1980. In the meantime, import and export of goods and services has grown from 13% to 26%.[18] Remittances have also grown. The data show a positive relationship between trade and growth, while investment remains constant, but the devil is in the detail. While GFCF is stable at the aggregate level, in individual countries it reaches up to 45% for sustained periods during the critical accelerating phases of urbanisation.[19] On this basis, the data suggest that urbanisation needs to be accompanied by investment for it to drive increases in productivity.

These are meta-trends, but economic history confirms that they map the trajectory of economic development in North and South America, the Middle East, North Africa and parts of Asia (Collier, 2017[21]). What lessons do they have for the current rapid urbanisation in Africa and other parts of Asia?

In sub-Saharan Africa, GFCF fell from nearly half of GDP in 1980, to less than one fifth in 2018 (see Figure 5.6). In contrast, total services as a share of GDP increased from 45% to 52%, and remittances received expanded from 0.6% to 2.8%. Total government expenditure remained constant at one quarter of GDP on aggregate (World Bank, 2019[18]).

Figure 5.6. Urbanisation versus gross fixed capital formation



Source: (World Bank, 2019[18]), Urban population (% of total population) – sub-Saharan Africa (1980–2018); Gross fixed capital formation (% of GDP) – sub-Saharan Africa (1980–2018). https://data.worldbank.org/

In terms of economic history, urbanisation and capital investment (public and private, often subsidised) kick-started higher value-added trade in goods and services. This is a well-trodden and well-documented path.

It is also clear from the data that parts of Africa and parts of Asia are not following this route, but experiencing urbanisation without investment and services, and remittance growth without higher value jobs and wages.[20] Have they found an alternative road? Can they consume their way to prosperity through an army of informal and/or small businesses? Or, more worryingly, are they not moving towards sustainable structural transformation?

The answer partly lies in productivity. Either services and remittances without investment will increase productivity, or new cities will become unproductive and environmentally unsustainable urban sprawls. Household incomes are a key barometer of what is happening. So far, the signs are not good. On aggregate, they are not increasing at a scale that indicates sufficient productivity growth.[21]

5.8.2. How blended finance can help (potentially)

Despite prolonged low interest rates, capital investment in the LDCs has remained subdued. On the face of it, this is a paradox. **A growing city represents a growing market, increasing land values, a larger tax base and a more diverse and skilled workforce.** There ought to be interest in the potential for returns on investment. But unfortunately, the global financial architecture does not encourage capital investment. First, the domestic capital markets in the urbanising LDCs are not broad enough (in policy and the variety of investment vehicles) or deep enough (in liquidity and volume). Second, borrowing on the international market at the scale required is discouraged due to current Bretton Woods policies on national debt; domestic subnational and non-sovereign infrastructure finance would mitigate against the sovereign debt issue, although not fully, as there are issues of contingent liability that need to be addressed.[22] Yet global private infrastructure funds, while strongly capitalised, including by pension funds, focus almost exclusively on already urbanised countries. So where will the money come from?

In recent times the international community has committed to subsidise investment at the volume required, for example through the financing of expansion by the European Union or the Belt and Road investments supported by China. However, these schemes do not address urbanisation in sub-Saharan Africa and parts of Asia.

Another example is green finance. The volume of concessional investment finance is significant, and appropriate investment vehicles, such as green bonds, are multiplying.[23] Furthermore, the geographical coverage is more friendly to sub-Saharan Africa and the rapidly urbanising parts of Asia, and the tenor and structure of much of this finance is appropriate.

Most green finance is blended, but not all blended finance is green.[24] Blended green finance is not the magic solution to the problem outlined here, but it could go some of the way towards addressing it. So far, rapidly expanding cities have not been able to tap into this second stream of financing because they have not been able to green their growth in verifiable ways. There are positive signs that this may be about to change, however.

A growing number of city networks and development finance institutions have coalesced around this agenda. For example, the Malaga Global Coalition for Municipal Finance established by UNCDF and the World Organization of United Cities and Local Governments (UCLG) promotes a financial ecosystem that works for local governments and municipalities to unlock finance for cities in the developing world to achieve sustainable, green and resilient growth. The challenge is to design blended investment packages that are appropriate to the cities' development needs, qualify for green finance and can attract enough private capital to mitigate pressure on sovereign balance sheet liabilities. Sub-sovereign and non-sovereign intermediaries can also relieve this pressure (Smoke, forthcoming[22]).

This is not easy. There has been an oversimplification that a paucity of bankable projects is the problem. It is not as straightforward as that. Projects that are eminently profitable often do not respect green criteria. Projects that are appropriate to the cities' needs are often green but not bankable. Projects that are green and bankable are not always urban in nature. Green finance can be attracted to projects with measurable greenhouse gas impact or measurable adaptation or resilience. Examples include transport, carbon sinks and adaptive or resilient land use (a large category from drainage to green roofs), energy, waste management, green built environment (e.g. heating or cooling), and the manufacture of green products. COVID-19 has caused a fiscal crisis, particularly for subnational governments.[25] This further exacerbates the situation and we are already seeing evidence that cities are moving to rebuild their fiscal space through bankable projects that increase revenue but not productivity (e.g. shopping malls).[26] On the other hand, there is evidence that the impact of the pandemic will bring value chains closer to home, and governments are now promoting local productive industry, which can be further accelerated if green.[27]

UNCDF has sponsored the Malaga Global Coalition for Municipal Finance with the UCLG to advocate for a financial ecosystem that works for local governments and municipalities. The Malaga Coalition promotes the global policy goals needed to unlock finance for cities in the developing world to achieve sustainable, green and resilient growth. One example is its financial instrument – the International Municipal Investment Fund – that will be managed by Meridiam and will invest in demonstration examples of blended green finance brought forward by UNCDF and its city partners.

Connecting urban investments with green blended finance through the Paris Agreement targets and other global goals is a route to increasing productive capacity in the rapidly urbanising parts of the world, in line with the sweep of economic history and the recommendations of the United Nations Committee for Development Policy towards the next LDC programme of action (UN, 2020[23]).

5.9. How blended finance can support the development of local capital markets in least developed countries

By Lasitha Perera

Lasitha Perera is Chief Executive Officer of GuarantCo, the guarantee arm of the Private Infrastructure Development Group (PIDG), which was established in 2005 to help mobilise local currency financing into domestic infrastructure in developing countries across Africa and Asia.

As a company founded to help mobilise local currency financing into domestic infrastructure in developing countries across Africa and Asia, GuarantCo promotes the development of local capital markets to support the alleviation of poverty.

Unfortunately, in reality, creating affordable infrastructure financed by local capital markets in LDCs can be very challenging. The high-double-digit interest rates, short tenors (typically three years), limited understanding of project financing, uncommercial collateral/security requirements and risk-averse financial market regulators are all common barriers that developers of infrastructure encounter. Nevertheless, as pension and insurance markets in LDCs develop, and the pools of capital requiring long-term investment opportunities consequently grow, local capital markets will have an increasingly important role to play in addressing the infrastructure financing gap.

Typically, investors in LDCs are restricted to investing in government securities or short-term deposits with the largest banks, thus creating significant concentration risks, which are neither desirable nor wise. This raises the question of why they are reluctant to be diversifying and investing in infrastructure projects, which in developed economies are viewed as a safe asset class. The answer lies in the local capital markets' capacity to assess the credit (repayment) risk of an infrastructure project and therefore how to price the credit risk of infrastructure projects appropriately.

GuarantCo uses blended finance in three ways to help address this capacity gap and to mobilise local capital markets to provide long-term local currency financing into infrastructure projects.

5.9.1. Leveraging public sector donor capital to provide guarantees to local investors

GuarantCo was designed to be a blended finance vehicle, receiving first loss (equity) capital from public sector donors (shareholders) against which it is able to write guarantees of up to three times the value of its shareholder equity. These guarantees in turn can, on average, mobilise up to a further four times private sector investment into infrastructure projects. Consequently, through GuarantCo, every USD 1 of public sector donor capital can mobilise up to USD 12 of private sector investment into an infrastructure project in the markets on which PIDG focuses, including LDCs.

GuarantCo has high international credit ratings from Fitch Ratings (AA-) and Moody's (A1) underpinned by the equity commitments of its government shareholders and its 15-year track record of providing guarantees without incurring any significant loss. These credit ratings make GuarantCo's credit risk equivalent to that of sovereign credit risk in LDCs. In other words, GuarantCo risk is as good as government risk as far as the local capital market is concerned. Thus, by GuarantCo providing a guarantee, the local capital market is able to price the risk of the infrastructure project against established government benchmarks.

GuarantCo is also able to use its guarantees to extend the tenor of a financing beyond established local capital market norms, while financing to match the long-term lifecycle of infrastructure is critical. In 2019, GuarantCo provided a guarantee to a bank in Bangladesh to provide a 13-year local currency loan

to the first utility-scale solar project in the country. GuarantCo was able to mobilise the bank to provide the financing with an initial 50% guarantee. Although the bank already had experience in financing the established power sector in Bangladesh, it needed to mitigate the first-mover risk attached to the solar project (despite the technology being proven and well established elsewhere) and to extend a tenor significantly longer than the market norm of five years. To help the bank overcome these challenges, GuarantCo's guarantee steps up from covering 50% of the loan after the first five years to gradually covering 100% in the later years.

5.9.2. Using PIDG technical assistance to provide grants to support capacity building workshops for local investors

In addition to providing guarantees, GuarantCo also regularly complements its transactions with PIDG technical assistance, the grant-providing arm of PIDG that is also donor-funded, to finance free-to-attend capacity building workshops in local markets. These are designed to help train and educate investors about how to assess the credit risk of infrastructure projects.

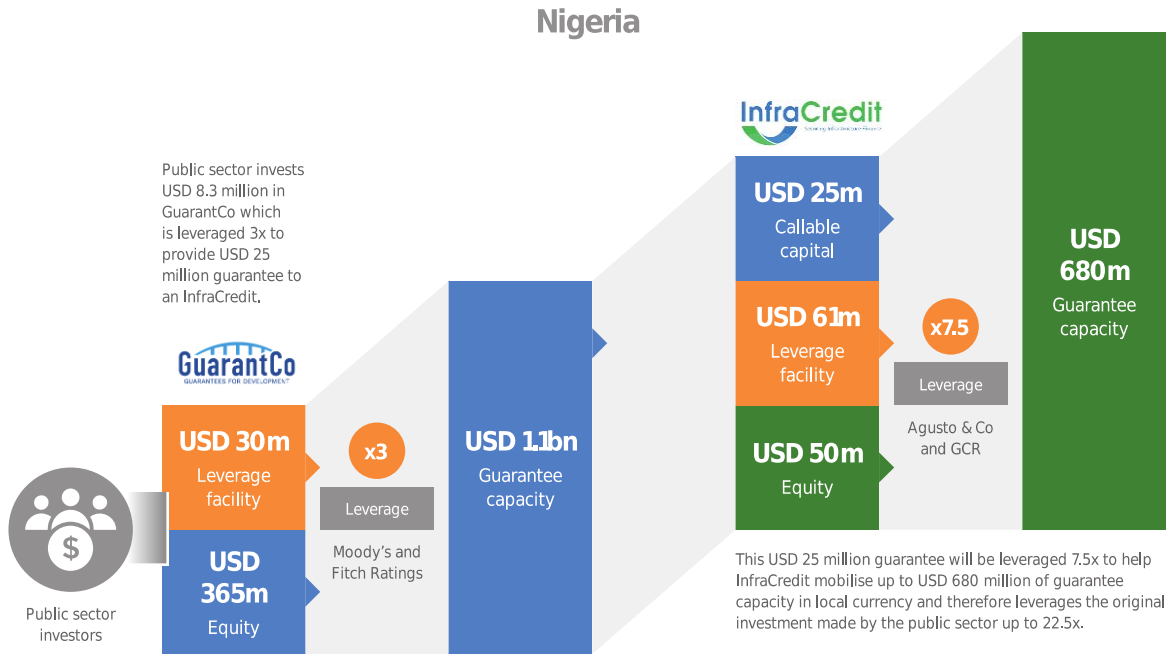
For example, in 2014, GuarantCo organised a one-week training workshop, funded by a grant from PIDG technical assistance, for a group of Nepalese banks to learn about project financing, which resulted in these banks providing a 16-year local currency financing with a 90% guarantee after originally seeking a 100% guarantee from GuarantCo. The 10% residual risk taken by the Nepalese banks was equivalent to 14 times the value of the grant provided by PIDG technical assistance to finance the training workshop, thereby demonstrating another way that blended finance can help to develop local capital markets.

5.9.3. Developing local currency guarantors to support the development of local capital markets

In 2017, PIDG partnered (through GuarantCo and PIDG technical assistance) **with the Nigerian Sovereign Investment Authority to set up and operationalise InfraCredit, a local currency guarantor dedicated to mobilising long-term local currency financing into infrastructure in Nigeria.** Through its guarantees, rated AAA locally, InfraCredit has enabled Nigerian pension funds to invest in long-dated infrastructure transactions for the first time, thereby opening up a pool of local currency liquidity equivalent to USD 2 billion, which previously had been unavailable to the infrastructure sector.

As can be seen from Figure 5.7, GuarantCo provides contingent capital (a form of guarantee) to InfraCredit that is leveraged through InfraCredit to enable every USD 1 of public sector donor capital in GuarantCo to mobilise USD 81 of private sector investment in Nigeria. GuarantCo is funded by public sector donor capital. Each USD 1 of public sector donor capital invested can be leveraged and deployed three times in GuarantCo investments to attract private capital. The contingent capital, a form of guarantee, that GuarantCo provided to InfraCredit can in turn be leveraged up to 7.5 times. As a result, public sector capital invested in GuarantCo can be leveraged up to 22.5 times through this structure. On this scale, guarantees can be truly transformational for local capital markets, as InfraCredit is proving. PIDG is actively working to build further versions of InfraCredit in other emerging markets to act as market champions.

Figure 5.7. InfraCredit



Note: Capital numbers as of December 2019
Source: Author

In summary, specialised blending facilities, such as GuarantCo, support the reduction of local currency risks for infrastructure projects, help to crowd in private sector investors and develop local capital markets that ultimately create a significant developmental impact on people's lives in lower-income countries throughout Africa and Asia. Since GuarantCo was established in 2005, the company has closed 55 transactions in 22 countries, provided 43 million people with improved access to infrastructure, created 235 000 jobs and enabled USD 5.6 billion of investments (PIDG, 2019[24]).[28]

5.10. Addressing the "missing middle" challenge in least developed countries

By Anders Berlin and Abdul-Rahman Lediju

Anders Berlin is the Director of UNCDF's Least Developed Countries Investment Platform, where he manages financial support of SMEs, small infrastructure projects and financial service providers.

Abdul-Rahman Lediju is an Investment Specialist for UNCDF, where he specialises as an Investment Adviser and Risk Manager for the LDCs Investment Platform.

The COVID-19 crisis, which has prompted national lockdowns, social distancing guidelines and disrupted regional and global value chains, has forced many businesses to endure a significant slowdown or stoppage of economic activities. In higher-income economies, businesses can apply for stimulus support to manage these unprecedented circumstances. In more vulnerable markets, such as the LDCs, limited fiscal capacity makes such options difficult, thereby risking the suspension and extinction of

many businesses, especially SMEs. This can have negative knock-on effects on unemployment levels, social unrest, conflict and forced migration.

Achieving the SDGs, recovering from the COVID-19 crisis and rebuilding inclusive and resilient economies will be virtually impossible for any LDC without SMEs. SMEs play a major role in formal employment (responsible for seven out of every ten new jobs created in emerging markets), economic growth (contributing up to 40% of emerging-market GDP), and innovation, creating more resilient and competitive economies (World Bank Group, 2017[25]). They deliver essential goods and services that allow communities to further grow and thrive. With population trends predicting that over 600 million new jobs will be needed to absorb a growing labour force, SMEs will be the engine for the jobs of the future.

These enterprises often do not receive the right type of financial solutions to grow. They are usually too large to receive financing from microfinance institutions, but simultaneously below the radar for classic local commercial banks, DFIs and impact investors. This is what is commonly referred to as the "missing middle" challenge.

There are three drivers that contribute to the unfortunate persistence of the missing middle: transaction costs, risk perception and investment readiness.

- **Transaction costs**. The costs to appraise and monitor investments for an SME are often the same as for larger transactions. Since the returns generated from any transaction are directly connected to transaction size, it follows that it is usually more expensive to handle SME deals, especially in contrast to larger enterprises.
- **Risk perception**. SMEs generally lack the attributes that conservative financiers like to see. These features include collateral options to offer as security, key founders having enough "skin in the game", profitability trends, business life, and investor or bank investment experience in the sector or region in question. The lack of these qualities may be compounded by the financier's lack of investment experience, or lack of data, in the sector or region in question, which leads to further uncertainty in evaluating risk. Moreover, commercial financiers lack the risk appetite to design tailored investment solutions at large scale to overcome these traditional constraints. Many SMEs therefore rely heavily on friends and family, as well as community-based informal lenders who exploit the absence of formal solutions by providing tougher terms and pricing (Runde, Yayboke and Ramanujam, 2019[26]).
- **Investment readiness**. SMEs sometimes lack the fluency to engage with local commercial banks and investors in a way that can yield positive results. For example, sustained engagement with a prudent investor or bank requires the ability to build (and maintain) robust financial models, and to design strategic business plans that include a clear revenue model description, market and competition analysis, customer segmentation details, detailed strategies to finance growth, and a logical sales strategy to acquire and maintain customers.

Solving a problem as complex as the missing middle financing gap, especially during a pandemic, requires collective action. It is well understood that public stakeholders alone, acting through ODA and domestic national fiscal plans, cannot generate enough resource flows to meet this development challenge (Runde, Yayboke and Ramanujam, 2019[26]).

One solution would be to establish investment platforms or facilities that take "on higher risk" and invest in "smaller projects with growth potential and longer investment horizons". Such a platform or facility should take into account that SMEs need different financial solutions at various stages of their lives – start-up, growth (early and mid) and expansion (Runde, Yayboke and Ramanujam, 2019[26]). UNCDF, for example, through its LDC Investment Platform, manages a portfolio of loans and guarantees on its balance sheet, focused on nurturing early-stage missing middle enterprises and projects in LDCs. By providing catalytic capital and technical assistance, we help to de-risk these businesses and enable them to access additional blended and commercial capital.

UNCDF's finance capabilities include offering solutions that can respond in terms of pricing (concessionary terms), **grace periods** (up to 36 months), **ranking** (UNCDF can invest in any position in the investment target's debt capital structure), **risk coverage** (subordinated and pari passu guarantees) **and tenors** (12 months to 15 years)**.** Moreover, UNCDF invests with systemic goals in mind – either to demonstrate and build market viability, to unlock the ability of other financiers to join in, or both. The LDC Investment Platform is 100% backed by grant donations and the revolving use of the funds means that a relatively small amount of capital has the potential to support numerous businesses and amplify development impacts over time and where the support is needed most.

Another complementary solution to tackling the missing middle financing gap is to pool public and private funding in structured blended finance vehicles that offer flexible, risk-tolerant capital solutions to SMEs that are otherwise generally not available from existing funds or financiers (Johnston, 2019[27]). In UNCDF's experience of working alongside Bamboo Capital Partners on the missing-middle-focused BUILD Fund, key considerations include mobilising the right proportion of public versus private capital, and implementing the right workflows to significantly support the missing middle in a cost-efficient (and therefore scalable) way (UNCDF, 2020[28]).

Paradoxically, the higher the proportion of public capital, the more risk-tolerant and flexible the blended finance vehicle can be. Striking the right balance is key in this regard, especially given ODA resource scarcity. In the case of the BUILD Fund, several layers (or "tranches") of capital will be used to invest in the same future portfolio of SMEs, but with different risk and return features for the ultimate investors dependent on the tranche.

If there is a loss, the first-loss (or "catalytic") tranche will be the first to bear it, thereby protecting the other layers of investors. The first-loss layer appeals to public actors who can use their dollars beyond grant-making to support their development objectives. If the BUILD Fund measures risk properly, the initial dollar invested can grow, be recycled for future investments, and further amplify development gains. The upper investment layers are designed to appeal to private actors. These potential investors would receive an annual, reasonable return, and would also be protected by a significant first loss layer (20% protection) in the event of losses in the underlying investment portfolio, including foreign exchange losses. In other words, the portfolio would have to effectively lose one-fifth of its value before a private investor's initial capital is affected. This represents a significant cushion to support the crowding in and blending of different sources of capital to address the missing middle challenge.

Regarding workflows, UNCDF will leverage its in-house footprint, development expertise, technical assistance resources, and increased investment origination and due diligence capacity to develop a pipeline of investable businesses for BUILD. This will drive down some of the costs that would otherwise be fully borne by Bamboo Capital Partners and the vehicle itself.

The pandemic has reminded us that our social, public health and economic systems are intimately interconnected. SMEs, which navigate the missing middle challenge daily, are not likely to be rescued by government stimulus packages to remain resilient through the crisis. It is imperative to look to risk-tolerant facilities and blended finance to support these businesses, their customers, suppliers and their workers in the poorest and most vulnerable communities around the world.

5.11. Out of the shadows into the limelight: national development banks as key actors in the decade of action

By Samantha Attridge

Samantha Attridge is a Senior Research Fellow and development finance expert for the Overseas Development Institute (ODI), specialising in innovative and blended finance, DFIs and national development banks.

5.11.1. Growing recognition of the key role of national development banks

National development banks (NDBs) are driving change in their countries by providing crucial funding and mobilising private investment in support of the SDGs and the Paris Agreement. Just under two thirds of LDCs have an NDB. To date, NDBs have been largely overlooked, especially in international policy discussions, but change is afoot. There is growing recognition that these institutions have made important achievements and have further huge untapped potential to support the implementation of these two key agendas.

5.11.2. Supporting the transition to climate-smart growth

Take, for example, the urgent need to lock in climate-smart growth and the need for countries to invest in climate-smart infrastructure. This is not an easy task for any country, not least for many LDCs, whose capital markets are not that well developed and whose public finances are stretched. Climate-smart investment often requires large upfront investment with long payback periods, requiring long-term financing, which is not widely available. When it is, it is extremely costly.

Other challenges include the risk-to-profit ratio associated with potentially risky new climate-smart technologies, and uncertainty surrounding the security of revenue generation stemming from possible changes to government policy. All these challenges are compounded by the fact that significant externalities, such as decreasing carbon emissions, are not yet reflected in market prices. For these reasons, private finance has not – and does not – naturally flow to climate-smart investments, especially in LDCs.

Cue NDBs, which are uniquely placed to overcome these challenges. Thanks to their development mandate and financing models, they can provide longer-term, more affordable financing than what is available in the market. And with their unrivalled knowledge of local markets and long-standing relationships with local private and public sectors, they possess important comparative advantages over the multilateral and bilateral banking system. Deeply rooted into the local context, NDBs are well placed to effectively and efficiently mobilise, intermediate and channel climate-smart finance and investment.

5.11.3. Realising the potential of NDBs: three preconditions

In many countries, including LDCs, the role of NDBs is changing. Traditionally, NDBs acted as public financiers of infrastructure investment. But many now play multiple roles, including focusing on the mobilisation of private investment through the blending of public development capital with their own account resource, the development of bankable pipelines, and the shaping of policy frameworks to incentivise and support climate-smart infrastructure investment (ODI, 2020[29]). To fully capitalise on the unique position of NDBs to drive investment in climate-smart infrastructure, three interlinked and mutually reinforcing preconditions need to be in place.

Good governance

Good governance underpins the willingness of governments to invest in NDBs, and the willingness of private investors, MDBs, DFIs and international climate funds to partner with them. It also affects their ability to develop and access capital markets. Well-governed and well-run NDBs with clear and stable green mandates are more likely to be integrated into policy frameworks and to have a seat at the policy table, as they are better able to deliver government objectives. This leads to a virtuous circle of good governance.

Well-resourced NDBs

NDBs need enough resources to enable them to operate at the scale required to support the transition to climate-smart growth in a meaningful way. Apart from a few large NDBs such as those in Brazil, China and Germany, most are constrained in their ability to finance and mobilise private investment at large scale. Access to developed local capital markets can help NDBs to grow and overcome scale challenges, given the real and perceived fiscal constraints in many LDCs. Where these markets are less developed, NDBs can work closely with the government, regulators and the international community to develop them. This is an area that is often overlooked, but is crucial to optimise NDB resource and mobilise private domestic savings into climate-smart investment.

International support

Some international public actors are working closely with NDBs and are fully engaged, while others have yet to take the leap, especially in many LDCs. In our research, we found good examples of this collaboration yielding positive results, including NDB governance reform and, in some cases, even protecting NDBs from political interference. Access to international concessional climate finance and the associated capacity building has also played an important role in helping NDBs to develop their climate-smart investment portfolios, especially building pipelines of investable opportunities and bolstering the capacity of NDBs to undertake climate-smart investment. The problem is that NDBs – which are uniquely placed to leverage this capital to maximum effect – do not have access to it, especially in LDCs.

An agenda for action

All this suggests a very clear action agenda. At the country level, NDBs need to strengthen their governance in order to improve their performance and shift their business models to allow them to fully support the mobilisation agenda. For their part, governments need to give NDBs clear and stable mandates, ensure they are adequately resourced, that supportive policy and regulatory frameworks are in place to incentivise investment, and that NDBs are integrated within these.

At the international level, MDBs, regional development banks (RDBs), DFIs and international climate funds need to step up their engagement with NDBs and support the development of their capacity. This engagement should be based on their respective comparative advantages. Smaller NDBs in LDCs can utilise their non-financial strengths to identify, develop and originate investment opportunities helped by direct access to concessional climate finance, as is the case, for example, for the Uganda Development Bank and the Development Bank of Rwanda; and MDBs, RDBs and DFIs can bring their financial might to help to catalyse private investment in these opportunities.

As we enter the decade of action we need to move away from business as usual and seek to build new partnerships and ways of working. Seizing the opportunity to embrace the potential of NDBs will help bring fresh impetus to this agenda and help to accelerate our efforts to achieve the SDGs and meet the targets of the Paris Agreement.

5.12. Promoting transparency in blended finance

By David Hughes

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As blended finance continues to evolve as an important component of the development finance toolkit, a growing number of development practitioners, including Global Affairs Canada, are looking at how to improve the effectiveness of blended financing mechanisms to achieve shared sustainable development objectives.

To make blended finance a scalable tool, capable of having a significant impact on SDG achievement, we need to know more about what works and where we can improve the effectiveness of blended finance mechanisms when it comes to both financial performance and development impact. Donors have an important role to play and are well placed to support the development of this evidence by creating benchmarks, monitoring trends, promoting transparency, identifying and diffusing best practices, and advocating the use of blended financing mechanisms in developing countries and frontier markets.

Yet challenges persist for all stakeholders. The international community needs access to more reliable and robust disaggregated and gender-sensitive data about blended finance projects. Access to better data will allow more accurate risk/return calculations to ensure investments are financially sustainable and to strengthen accountability to shareholders and taxpayers. Reliable data on financial performance can also help to build a public record of accomplishment for blended finance and potentially unlock greater volumes of commercial investment. This is particularly important for blended finance in the LDCs, where the perception of risk is heightened and evidence to the contrary could mobilise new forms of financing.

By increasing transparency in our blended finance transactions, we can:

- improve access to disclosure data and information, particularly for emerging market stakeholders
- better understand the direct impact/benefits of blended finance on poverty alleviation and/or on other relevant SDGs
- ensure reliable, disaggregated data collection and impact measurement
- promote a fair, open and inclusive process for participation in blended finance projects
- encourage proper contract enforcement and respect for property rights
- gain a better understanding of the amounts of private finance mobilised
- demonstrate the catalytic nature of investments and encourage the continued participation of stakeholders in blended finance
- strengthen trust and public accountability in terms of the financial and development performance and outcomes of blended finance transactions (e.g. volumes of ODA spent, concessionality provided, and social and environmental outcomes and impact) (OECD and DANIDA, 2018[30]).

A recent effort to mainstream principles and perspectives on blended finance is the Tri Hita Karana (THK) Roadmap for Blended Finance, which sets out shared values and key action areas for effectively scaling up blended finance operations (OECD, 2018[31]). Canada, together with the OECD and the IFC, co-chaired a multi-stakeholder working group on transparency in blended finance within the THK framework, which has been looking at proposals to improve blended finance transparency. The research and discussions among working group members have highlighted a need for greater transparency, particularly for impact data, in blended finance. At the same time, the members recognise that there are

challenges, such as undermining competition, that need to be addressed, as well as legal limitations and/or market practices that make transparency at the project and activity level challenging.

The working group concluded that building a common understanding of the context, challenges and opportunities is critical to maintaining a conducive environment for the effective scale-up of transparency in blended finance. The working group's recommendations include:

- maintaining multi-stakeholder dialogue and collaboration for transparency in blended finance
- establishing clear roles and responsibilities across all stakeholder groups
- agreeing on minimum reporting requirements for different stakeholders
- considering the feasibility of establishing common reporting principles
- enhancing access to information on existing blended finance facilities and investments.

These recommendations recognise that increased transparency around operationalising blended finance is not only an end in itself; it also enables all actors to improve co-ordination, learning, trust, accountability and effectiveness with a view to strengthening sustainable development impact and the achievement of the SDGs.

As the international community responds to the effects of the COVID-19 pandemic, particularly in the LDCs, we need to ensure that our investments support sustainable outcomes. To safeguard development gains, the international community will need creativity in how it deploys international assistance tools, and a clear vision for how blending public and private finance can make a real difference by helping to stabilise economies and spur recovery. Canada looks forward to exploring the opportunities with our partners and to contributing to the thought leadership around blended and innovative financing for sustainable development.

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Notes

[1] In this scenario, the strategy stipulates that the public sector would account for around 34% of the financing for the SDGs while external sources, including foreign direct investments, would account for 15%, with the remaining gap being filled by non-state organisations.

[2] A mapping of 240 development co-operation projects in Bangladesh with the active participation of the private sector, carried out by the GPEDC, found that government institutions were listed as partners for only 9% of projects, while 8% involved civil society organisations and less than 1% involved domestic business associations (GPEDC, 2018[2]).

[3] Blended concessional finance is the combination of concessional finance from donors or third parties alongside the IFC's own normal account finance and/or commercial finance from other investors, to develop private sector markets, address the SDGs and mobilise private resources.

[4] There is a significant overlap across the categories of LDCs, other low-income countries, and fragile and conflict-affected situations. Since most fragile and conflict-affected situations are classified as either low-income countries and/or LDCs, the rest of this guest contribution will focus on low-income countries and LDCs.

[5] More information on how concessionality is calculated and levels can be found at: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/bf.

[6] Concessionality levels by product and themes in the IFC's blended finance portfolio can be found at: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/bf.

[7] More information on the IFC's governance system for blended concessional finance can be found at https://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/financial+institutions/resources/blended+concessional+finance+governance+matters+for+impact.

[8] More information can be found at: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/bf/bf-details/bf-dfi.

[9] When using blended finance, the IFC publishes information on concessionality at the transaction level (see the data portal at https://disclosures.ifc.org).

[10] The IDA Private Sector Window contribution includes a pooled first loss guarantee as well as a limit expansion facility to help GTFP leverage at least USD 1 billion in trade finance in countries eligible for the IDA Private Sector Window.

[11] These include performance-based incentives offered through the Global SME Finance Facility (GSMEF), the Women Entrepreneurs Opportunity Facility (WEOF) and/or the Women Entrepreneurs Finance Initiative (We-Fi).

[12] See *Can Blended Finance Work to Leave No One Behind?*, 2020 Blended Finance LDC Consultation; and (Convergence, 2020[32]).

[13] a2i – a whole-of-government programme of the information and communications technology division, supported by the cabinet division and the United Nations Development Programme, that catalyzes citizen-

friendly public service innovations simplifying government and bringing it closer to people. It supports the government to be at the forefront of integrating new, whole-of-society approaches to achieve the SDGs.

[14] The annual zakat estimation is based on expert opinion.

[15] Budget data from the Ministry of Finance, Government of Bangladesh (2015–2016, 2016–2017, 2017–2018, 2018–2019, 2019–2020) courtesy of the Economic Relations Department.

[16] UNCDF and International Labour Organization feasibility study on the MSME financing digital platform linked to the alternative stock exchange, Zimbabwe.

[17] In many big cities in Africa, their populations have increased by more than 1 million between 2010 and 2020, such as Addis Ababa, Ethiopia (from 3.1 million to 4.8 million), Dar es Salaam, Tanzania (from 3.9 million to 6.7 million), Luanda, Angola (from 5.3 million to 8.3 million), and Kinshasa, Democratic Republic of the Congo (from 9.4 million to 14.3 million). Data source: https://population.un.org/wup/DataQuery.

[18] The contribution of GFCF to GDP has remained at about the same level with slight fluctuations from 25.6% in 1970 to 23.6% in 2018. Exports of goods and services as a share of GDP grew from 13.6% to 30.1%, and imports of goods and services from 13.7% to 29.3%. Data source: (World Bank, 2019[18]).

[19] For example, in Korea, GFCF averaged 35% of GDP from 1970 to 1990 while urbanisation was rapidly increasing. Korea also shows that, once urbanisation reaches 80% it levels off and can even decline – a phenomenon seen in many countries.

[20] Countries that are not following the usual path are primarily the LDCs in Africa and Asia. Poor regions in middle-income countries in Africa and Asia are also experiencing urbanisation without investment.

[21] Some African countries are urbanising rapidly with real GDP growth lagging, such as Angola, Malawi and Mozambique. Also see: UNCDF (2020). *Capital Locast – Episode 9. Podcast interview with Jean Pierre Elong Mbassi, April 2020*. https://capital-locast.captivate.fm/episode/capital-locast-episode-9.

[22] A contingent liability arises for central governments when they are held accountable directly or indirectly for debts that are on the balance sheet of local governments. Often it is assumed that, as a last resort, central government would underwrite these debts, therefore local government borrowing can impact the national credit rating. See South Africa Local Government: Municipal Finance Management Act (2003). https://www.westerncape.gov.za/Text/2004/8/mfma.pdf.

[23] According to the *Global Landscape of Climate Finance 2019*, by the Climate Policy Initiative, total global climate finance flows had been increasing rapidly from USD 350 billion in 2013 to USD 550 billion in 2018. According to the Climate Bonds Initiative, global green bonds reached USD 257.7 billion in 2019, driven by European, Asia-Pacific and North American markets. See https://www.climatebonds.net/resources/reports/2019-green-bond-market-summary.

[24] Blended green finance investors include the Green Climate Fund, the European Investment Bank, other development finance institutions, asset managers, and other private investors.

[25] 2021 will be a very challenging year for local governments, with increased demands for their services and reduced fiscal space. In this context, UNCDF has started a new initiative on Rebuilding Local Fiscal Space to understand the loss of local fiscal space due to the COVID 19 pandemic and to unlock access to public and private capital for local fiscal and economic recovery.

[26] For instance, due to the significant loss of local government revenue, the city of Kumasi is focusing municipal investment more on projects that can generate revenues quickly but not contribute to productivity growth, such as car parks and shopping malls. This is also happening in other developing cities. UNCDF, through its International Municipal Investment Fund Technical Assistance Facility, is supporting cities to rebuild local fiscal space in a more sustainable way (see footnote 24).

[27] For example, Burkina Faso is starting to make pharmaceutical equipment that was previously imported.

[28] For more information, visit https://guarantco.com/blendedknowledge/.

Annex A. The least developed country category: criteria for inclusion and graduation

The United Nations classification of least developed countries (LDCs) currently encompasses 47 countries: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Djibouti, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, the Sudan, Timor-Leste, Togo, Tuvalu, Uganda, the United Republic of Tanzania, Vanuatu, Yemen and Zambia (UN, 2018[1]).

LDC status and progress are reviewed every three years by the Committee for Development Policy (CDP), a subsidiary body of the United Nations Economic and Social Council. The CDP uses the following three criteria to monitor the LDCs:

- gross national income (GNI) per capita (three-year average), with a threshold for inclusion in the LDC list of USD 1,025 and a threshold for LDC graduation of USD 1,230;
- a human assets index, composed of three health indicators (under-five mortality rate, percentage of population undernourished and maternal mortality rate) and two education indicators (gross secondary school enrolment ratio and adult literacy rate), with the LDC inclusion threshold set at 60 and the LDC graduation threshold at 66;
- an economic vulnerability index (to be renamed the economic and environmental vulnerability index), composed of eight indicators: (i) share of agriculture, forestry and fishing to GDP; (ii) remoteness and extent of being landlocked; (iii) merchandise export concentration; (iv) instability of exports of goods and services; (v) share of population in low elevated coastal zones; (vi) share of population living in drylands; (vii) instability of agricultural production; and (viii) victims of natural disasters. The LDC inclusion threshold is set at 36 and the LDC graduation threshold at 32 (UN, 2018[2]).

A country is recommended by the CDP for graduation from LDC status if it has met graduation thresholds for at least two of the three criteria at two successive triennial reviews. However, a country with the three-year average per-capita GNI sustainably above twice the normal graduation threshold may be recommended for graduation even if it does not meet the graduation threshold for either of the two other criteria.

Since the LDC category was introduced and the first group of LDCs was listed by the United Nations in 1971, only five countries have graduated from the LDC status: Botswana in 1994, Cabo Verde in 2007, Maldives in 2011, Samoa in 2014 and Equatorial Guinea in 2017. The CDP last conducted a triennial review of the list of LDCs in 2018, when it found that Bhutan, Sao Tome and Príncipe and Solomon Islands were eligible for graduation for the second consecutive time and recommended them for graduation from the list.

Annex B. Financing sustainable development in least developed countries

This annex highlights the development and well-being indicators in least developed countries (LDCs). It provides an overview of the financing for sustainable development landscape in LDCs. It analyses how the financing for sustainable development mix differs across country groupings. It also examines the roles of the different sources of financing in LDCs, such as domestic resources and external finance – that is, development finance, remittances and private investment.

Development and well-being indicators: Least developed countries versus other developing countries

In the final year of the Istanbul Programme of Action, evidence shows that despite significant progress in certain areas, LDCs still face structural impediments to eradicating poverty through economic growth, structural transformation, the building of productive capacity or through increasing the share of exports (UN, 2020[3]). Moreover, LDCs have been hard hit by COVID-19 and the ensuing global economic downturn, exacerbating existing vulnerabilities.

As Table B.1 below shows, the latest available data show significant differences between LDCs and other developing countries across dimensions of human and social development, as well as economic and environmental sustainability. In 2017, 36% of the population in LDCs lived below USD 1.90 per day. LDCs severely lag behind across all human development dimensions, namely life expectancy, education and gross national income (GNI) per capita and gender equality. Women still face significant barriers to economic opportunities in LDCs, in particular in the informal sector, where 50% of women employees are unpaid, compared with 33% of men. Only 45% of the population in these countries had access to electricity in 2017 and merely 37% of the population use at least basic sanitation facilities, compared with more than double that in other developing countries. Moreover, a third of the population in LDCs still lack access to clean drinking water.

Table B.1 also shows that the economic sustainability outlook in LDCs is particularly worrying. In 2017, LDCs had a GNI per capita level of less than half that of other developing countries. While LDCs' real GDP growth in 2018 beat that of other developing countries on average, real GDP growth per capita lags behind (3.1% for LDCs versus 3.6% for other developing countries). The agriculture sector plays a much more prominent role in LDCs' economies (its value added represents almost 25% of GDP in 2017) with respect to other developing countries (almost 10% of GDP). As such, LDCs have made slow progress in the structural transformation of their economies and transitioning from sectors with low productivity to sectors with higher productivity.

The domestic credit provided by the financial sector in LDCs amounted to 29.6% in 2017, as opposed to 58.5% in other developing countries, which shows the low level of financial sector development. LDCs also show low levels of gross domestic savings and gross capital formation. LDCs still face major barriers in attracting investment and in developing the private sector. Improvements in the enabling environment have been observed in some cases, with the time and cost of business start-up procedures (as a share of GNI

per capita) declining from about 89% in 2012 to almost 41% in 2019 (World Bank, 2019[4]). However, only five LDCs ranked among the top 100 in the 2018 Ease of Doing Business index.

LDCs' share of global trade is marginal at around 1%. SDG target 17.11 calls for doubling the share of LDCs in global exports by 2020, a target that has not been achieved. LDCs are also less connected than other countries, with only two broadband connections per 100 people, compared with 11 in developing countries and 36 in developed countries (ITU, 2019[5]) and women are 33% less likely than men to access the Internet.

LDCs also lag behind in terms of environmental sustainability. While there is a relatively high renewable energy consumption across LDCs, the countries show signs of environmental degradation, namely in terms of forest area coverage and a faster rate of natural resource depletion than in other developing countries. Moreover, nine LDCs are small islands and developing states, which are highly vulnerable to the impacts of climate change and natural disasters. LDCs are disproportionately affected by natural disasters and the effects of climate change, with higher proportions of deaths caused by such events, and they bear significantly higher economic losses, compared with other countries.

Table B.1. Key development indicators: Least developed countries versus other developing countries

Indicator	LDCs	Other developing countries
Human and social development		
Human Development Index (2018) [1]	0.528	0.710
Life expectancy at birth (2018) [1]	65	72.6
Expected years of schooling (2018) [1]	9.8	13.2
Mean years of schooling (2018) [1]	4.8	8.8
Gender Inequality Index (2018) [1]	0.56	0.35
Poverty: share of population living below USD1.90 a day (2017) [2]	36.1	10.3
Demography		
Population, billion (2018) [3]	1	5.1
Share of world population (2018)	13%	68%
% urban population (2018) [2]	33.6%	53.9%
Annual population growth (2018) [3]	2.36%	1.27%
Income and composition of resources		
Real GDP growth (2018 annual average) [3]	5.4%	4.7%
Real GDP growth per capita (2018 annual average) [2]	3.1%	3.6%
GNI per capita (USD, 2017) [3]	2,722 [2]	5,833 [3]
Agriculture, forestry, and fishing value added (% of GDP) (2017) [3]	24.9%	9.9%
Industry value added (% of GDP) (2017) [3]	23%	26.5%
Services value added (% of GDP) (2017) [3]	44.8%	55%
Economic sustainability		
Domestic credit provided by financial sector (% of GDP) (2017) [3]	29.6%	58.5%
Gross domestic savings (% of GDP), 2016 [2]	19.3%	33.6%
External debt stocks (% of GNI), 2017 [2]	29.9%	18.8%
Total debt service (% of exports of goods, services and primary income), 2017 [2]	7.8%	11.4%
Gross fixed capital formation (% of GDP) (2017) [3]	24.6%	22%
Environmental sustainability		
Renewable energy consumption (% of total final energy consumption) (2015) [3]	63.7%	26.2%
Percentage of land area covered by forest (2018) [2]	27.4%	28.3%
Natural resource depletion (% of GNI) (2017) [3]	8.4%	4.3%
Quality of standards of living		
Vulnerable employment (% of total employment) (modelled International Labour Organization estimate) 2018 [3]	72.7%	37.6%

Population with access to electricity (2017) [2]	45%	92%
Population using at least basic drinking-water sources (2017) [3]	66.4%	90.5%
Population using at least basic sanitation facilities (2017) [3]	36.6%	80.4%

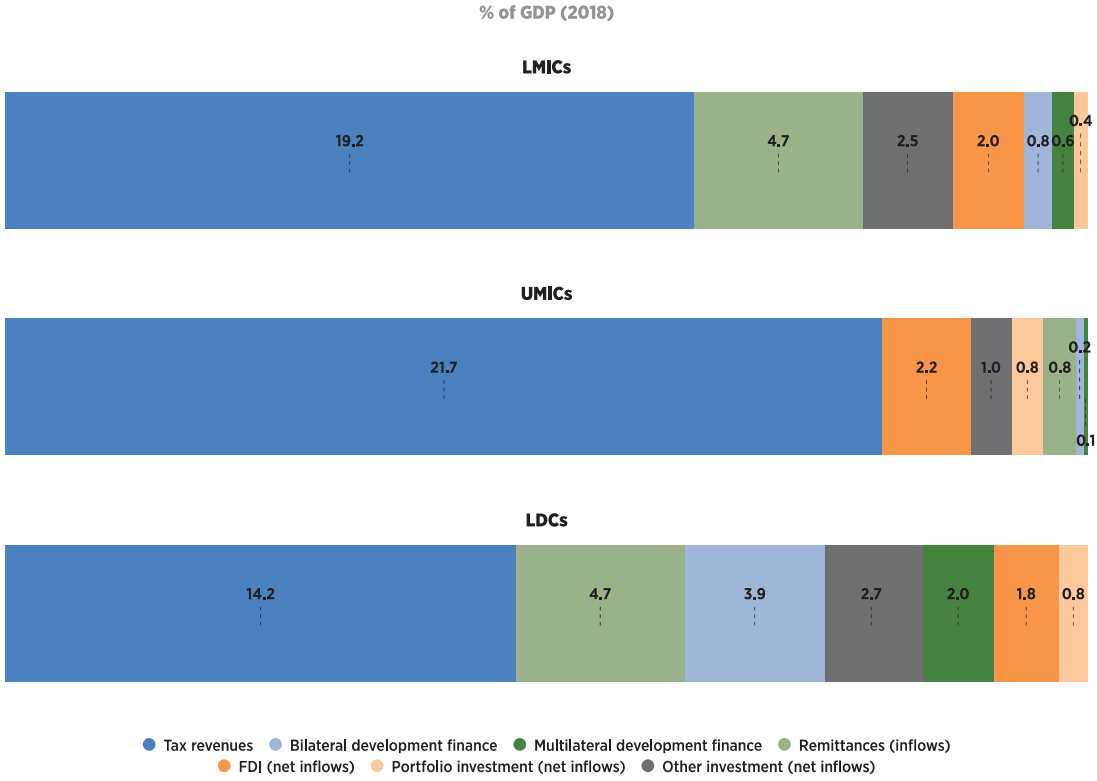
Note: "Other developing countries" are all ODA-eligible countries that are not classified as LDCs. Countries for which data were not available were excluded from the calculations.
Source: [1] Own calculations based on (UNDP, 2018[6]) Human Development Data, http://hdr.undp.org/en/data.
[2] (UNCTAD, 2018[7]) Statistical Tables on the Least Developed Countries, 2018, https://unctad.org/system/files/official-document/ldcr2018stats_en.pdf [3] Own calculations based on (World Bank, 2019[4]), World Development Indicators database (accessed May 2020).

Least developed countries' financing for sustainable development landscape: an overview

Financing for sustainable development: LDCs versus other country groupings

Although financing challenges are common to all developing countries, LDCs face particular barriers. Financing investment through domestic resources is challenging for LDCs, which have low levels of income and domestic savings and often ineffective domestic resource mobilisation. Although tax revenues represent on average the largest source of financing for sustainable development in developing countries, tax revenues account for a much lower share of GDP in LDCs (14.2%), compared with lower middle-income countries (19.2%) and upper-middle-income countries (21.7%), as Figure A B.1 shows. For LDCs, external finance (i.e. development finance, remittances, foreign direct investment (FDI), private investment and other investment, with each having specific financing purposes) represents a larger share of the financing mix than domestic finance.

Figure A B.1. Sources of financing for sustainable development across country groupings

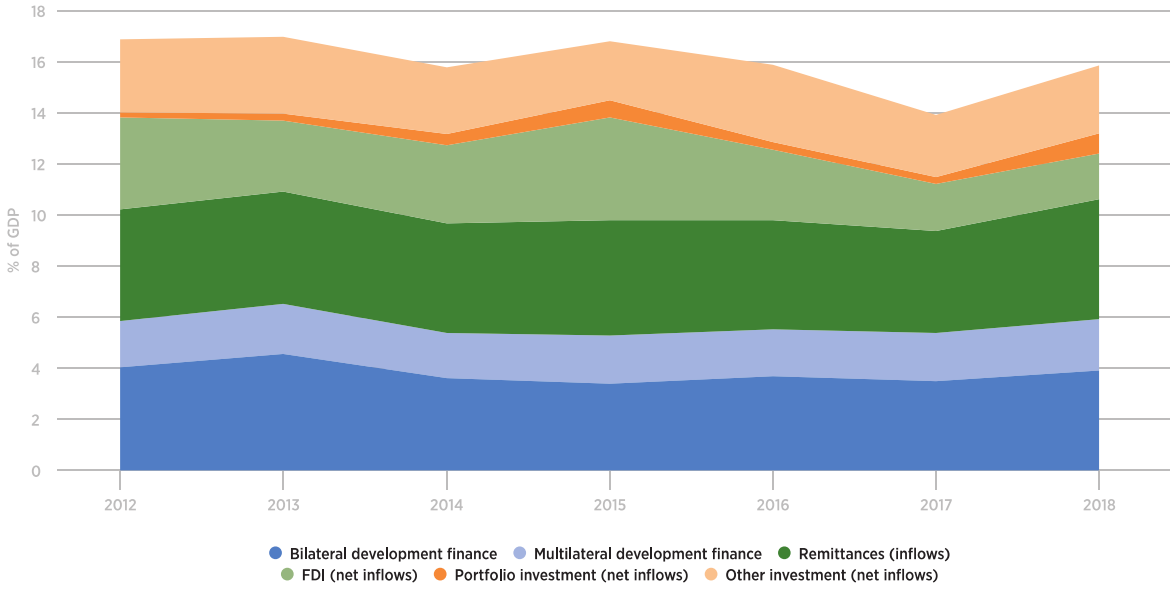


Note: LDCs = least developed countries; LMICs = lower middle-income countries; UMICs = upper middle-income countries
Source: Authors based on data collected for (OECD, 2020[8]) *Global Outlook on Financing for Sustainable Development 2021*.

External finance in LDCs

As Figure A B.2 below indicates, external finance represents a major source of financing for LDCs (16% of GDP in 2018), and has remained relatively stable throughout 2012–2018. Bilateral and multilateral development finance, which was stable over the same time (on average 5.7% of GDP), experienced a slight increase in 2018. Remittances represented, on average, over 4% of GDP in LDCs and also rose in 2018. Private investment inflows accounted on average for 6% of GDP in LDCs throughout the period, with FDI being the most prominent. However, these are also the most volatile source of external finance, experiencing a significant drop in 2017 and further decrease in 2018 (in relative terms). Further research highlights that, in 2019, FDI inflows to LDCs declined by 5.7% to USD 21 billion, accounting for merely 1.4% of global FDI. LDCs were the only country grouping to experience a drop in FDI flows in 2019, although with differences across countries (FDI increased only in African LDCs) (UNCTAD, 2020[9]).

Figure A B.2. External finance to LDCs over time



Note: bilateral development finance is the sum of bilateral concessional (bilateral ODA) and bilateral non-concessional finance (bilateral other official flows) and bilateral export credits, in disbursements. Multilateral development finance is the sum of multilateral concessional (multilateral ODA) and multilateral non-concessional finance (multilateral other official flows and commitments from the International Finance Corporation and the Green Climate Fund as proxy for disbursement), in disbursement.
Source: Authors based on data collected for (OECD, 2020[8]) *Global Outlook on Financing for Sustainable Development 2021* https://dx.doi.org/10.1787/e3c30a9a-en.

External indebtedness is a crucial issue for LDCs. According to the World Bank Group-IMF Debt Sustainability Framework, as of June 2020, six LDCs were classified as debt distressed, with an additional one in external debt distress, and 16 LDCs faced high risk of debt distress[1] (World Bank and IMF, 2020[10]). The composition of the debt stock of LDCs also changed significantly in the last decade, with an increasing share of debt held by private and non-traditional bilateral creditors (notably China). This is likely to pose challenges to creditor co-ordination (UN, 2020[3]).

Moreover, in International Development Association (IDA)-eligible, low-income developing countries,[2] commercial credit increased more than threefold from 2010 through 2019, going from 5% to 17.5% (of total external public debt) throughout the period, with the increase higher in “frontier economies” (low-income

and LDCs with international bond issuance). In particular, 38% per cent of these countries' external public debt is owed to private creditors, with 32% in bonds (UN/DESA, 2020[11]).

Development finance in LDCs

Looking specifically at development finance trends, Figure 2.1 in Chapter 2 shows that overall development finance to LDCs has been on an upward trend since 2015, with bilateral development finance largely exceeding multilateral.[3] ODA, which is provided on concessional terms,[4] largely dominates the official development finance landscape in LDCs. After a slight drop in 2016, ODA to LDCs has been rising since 2017, with total gross ODA disbursements reaching almost USD 59 billion in 2018 (or 5% of GDP). Preliminary data for 2019 suggest that, on a cash flow basis,[5] net bilateral ODA flows to LDCs increased by 2.6% in real terms (OECD, 2020[8]). However, ODA provided to LDCs by DAC donors accounted for only 0.09% of the GNI of donor countries in 2018, well below their 0.15%–0.20% ODA-to-GNI commitment.[6] This implies a shortfall of external development finance for LDCs (UN, 2020[12]). As illustrated in Figure 2.1 in Chapter 2, both bilateral and multilateral donors are also increasingly extending development finance at non-concessional terms, also referred to as other official flows (OOF),[7] which reached an all-time peak in 2018, at USD 6 billion extended by bilateral donors, and USD 3.2 billion by multilaterals.

Annex C. Methodological note

The quantitative analysis on the state of blended finance in LDCs was conducted using different data sources, namely OECD Development Assistance Committee (DAC) statistics on private finance mobilised by official development interventions (OECD DAC, 2020[13]); Convergence database of historical blended finance transactions (Convergence, 2020[14]); as well as results from the 2018 OECD Survey on Blended Finance Funds and Facilities (Basile, Bellesi and Singh, 2020[15]); (Basile and Dutra, 2019[16]).

The OECD DAC methodology for measuring the amounts mobilised from the private sector was developed under a high-level mandate from DAC members. Reporting on amounts mobilised by official development finance from the private sector has been part of the regular OECD DAC data collections since 2017. Official development finance includes: (i) bilateral official development assistance (ODA), (ii) other official flows (OOF) for development purposes (including refinancing loans) that do not meet the criteria set by the ODA definition, and (iii) the concessional and non-concessional operations of multilateral financial institutions.

In the case a few providers, data are collected through complementary ad hoc surveys (e.g. the Dutch entrepreneurial development bank, FMO). The methodology progressively included guidance for reporting on the amounts mobilised for seven major leveraging mechanisms: guarantees, syndicated loans, shares in collective investment vehicles (CIVs), direct investment in companies and special purpose vehicles, credit lines, project finance schemes and simple co-financing arrangements. The OECD DAC dataset on mobilisation includes information for all seven leveraging mechanisms that goes back to 2012. The private finance mobilised dataset is dynamic and continually being updated. This report presents the latest available data.

Activity-level data on the amounts mobilised are, however, in many cases subject to confidentiality constraints. Concerning some multilateral development banks (MDBs), data-sharing agreements needed to be developed to facilitate the data provision to the OECD. Furthermore, the use of such data is often restricted to a specific number of analytical outputs. A joint MDB–OECD DAC working group on measuring mobilisation was set up in 2019 to address these concerns and discussions are ongoing. The private finance mobilised dataset is continually being updated due to staggered reporting by development finance providers. This report presents the latest available data.

The official providers who report to the OECD private finance mobilised are: African Development Bank, Asian Development Bank, Australia, Austria, Belgium, Canada, Caribbean Development Bank, Council of Europe Development Bank, Credit Guarantee and Investment Facility, Czech Republic, Denmark, Development Bank of Latin America, European Union institutions, European Bank for Reconstruction and Development, Finland, France, Germany, Global Energy Efficiency and Renewable Energy Fund, IDB Invest, International Fund for Agricultural Development, Inter-American Development Bank, International Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Ireland, the Republic of Korea, Luxembourg, Multilateral Investment Guarantee Agency, Netherlands, Nordic Development Fund, Norway, Portugal, Private Infrastructure Development Group, Slovak Republic, Spain, Sweden, Switzerland, United Kingdom, United States.

The report also benefits from analysis of the results of the 2018 OECD survey on blended finance funds and facilities. There were 180 complete survey responses collected, more than double the amount from the inaugural OECD survey held in 2017. The responding vehicles represent a total of USD 60.2 billion in assets under management. Further details on the methodology used for the survey, as well as on the

results are available in (Basile and Dutra, 2019[16]) and (Basile, Bellesi and Singh, 2020[15]). The OECD is currently running the 2020 edition of the survey.

The report also presents quantitative analysis contributed by Convergence, providing an additional perspective on blended finance in LDCs. The analysis by Convergence draws from its database of historical blended finance transactions. Whereas the OECD information draws from the annual reporting exercise undertaken as part of the OECD DAC statistics, Convergence collects information from other credible public sources (e.g. press releases, case studies, news articles), as well as through data-sharing agreements and validation exercises with its members. To be included in Convergence's database, the transaction must use concessional capital (public or philanthropic), whereas the OECD's scope extends to all development finance, independent of the terms of its deployment. For example, Convergence will not capture a fund that is purely concessionally funded, which aims to mobilise co-financing from the private sector for blending at the underlying investee level. This also helps to avoid double counting (e.g. counting a concessional facility and its underlying projects that have attracted private financing). As a result of these differences, Convergence and the OECD will often capture different levels of blending, which makes the two databases complementary. Another important difference is that Convergence captures the total deal size (including the development finance deployed), while the OECD accounts only for the amount of private finance mobilised in each operation.

Given the current state of information sharing, it is not possible for either of the data sources to be fully comprehensive. While some transactions may be captured in multiple sources, the information collected is complementary. The data sets are distinct from each other as they each capture a different segment of the blended finance market – see Table C.1 below for an overview of the main structural differences between the three data sources.

Table C.1. Differences between data sources

	Sources	Perimeter	Financial data captured	Frequency
OECD statistics on private finance mobilised for development	Since 2017, regular reporting by governments and multilateral organisations, with complementary collections to fill in data gaps for a few providers	All development finance (ODA and other official flows for development) at activity level	Amount of private finance mobilised by official development finance interventions according the OECD DAC methodology	Yearly, since 2015
OECD survey on blended finance funds and facilities	Surveyed managing organisations of CIVs	CIVs at capital level	Assets under management in the fiscal year	Ad hoc surveys in 2016, 2017 and 2020 (forthcoming)
Convergence database of blended finance transactions	Credible public sources and data-sharing agreements and validation exercises	Transactions using concessional (public or philanthropic) finance to mobilise additional private sector investment	Total transaction size (including development finance) based on pledges at deal closure	Continually updated, since 2005

Note: CIV = collective investment vehicle; DAC = Development Assistance Committee; ODA = official development assistance
Source: (Basile and Dutra, 2019[16]) Blended Finance Funds and Facilities: 2018 Survey Results, https://dx.doi.org/10.1787/806991a2-en.

Finally, the report also presents analysis on the financing for sustainable development landscape in LDCs, with data from the *OECD Global Outlook on Financing for Sustainable Development 2021* (OECD, 2020[8]). The methodology used for the data analysis is provided in the report.

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World Bank and IMF (2020), *Debt Sustainability Analysis (DSA)*, https://www.worldbank.org/en/programs/debt-toolkit/dsa (accessed on 25 June 2020). [10]

Notes

[1] The six LDCs in debt distress (overall and external debt) are Mozambique, Sao Tome and Principe, Sudan, Somalia, South Sudan and Zimbabwe. The 16 LDCs in high risk of debt distress (overall and external debt) are Afghanistan, Central African Republic, Chad, Djibouti, Ethiopia, Gambia, Haiti, Kiribati, Lao People's Democratic Republic, Liberia, Malawi, Mauritania, Sierra Leone, Togo, Tuvalu and Zambia.

[2] Eligibility for IDA support depends on a country's relative poverty, defined as GNI per capita below an established threshold and updated annually (USD 1,185 in the fiscal year 2021). Of the 47 LDCs, 45 are IDA-eligible. For further information, see https://ida.worldbank.org/about/borrowing-countries.

[3] Bilateral donors include members of the Development Assistance Committee (DAC) and those countries reporting their development finance to the OECD. Multilateral donors comprise multilateral organisations such as agencies and funds of the United Nations system, international and regional financial institutions (e.g. the World Bank, regional development banks, etc) and vertical funds.

[4] ODA mostly includes grant payments and, to a lesser extent, concessional loans (with grant element of at least 25%), with the primary objective to promote economic development and welfare in recipient countries.

[5] In 2014, DAC members decided to modernise the reporting of concessional loans by assessing their concessionality based on discount rates differentiated by income group, and introducing a grant-equivalent system for calculating ODA figures. Here, official development finance flows are presented on a cash basis – that is, the actual cash flow between donor and recipient countries. For further information, see: https://www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2019-detailed-summary.pdf.

[6] LDCs have exclusive access to international support measures, including for development co-operation. Donors made a long-standing commitment to provide the equivalent of 0.15 to 0.20% of their GNI in the form of ODA to LDCs, reiterated in the Addis Ababa Action Agenda and included in SDG target 17.2 (more at: https://www.un.org/ldcportal/commitments-regarding-oda-to-ldcs/).

[7] OOF include loans that do not meet the concessionality criteria of ODA (having a grant element of less than 25%), grants for representational or commercial purposes, and export credits.

Blended Finance in the Least Developed Countries 2020

SUPPORTING A RESILIENT COVID-19 RECOVERY

The least developed countries (LDCs) are the furthest from achieving the Sustainable Development Goals (SDGs). They are also likely to be hit the hardest by the COVID-19 crisis and badly need the additional private finance that blended finance can unlock. Yet evidence shows that too little private finance is mobilised for investment in LDCs. How can this be fixed?

The Blended Finance in the Least Developed Countries 2020 report is the third edition and second joint UNCDF-OECD report. It builds on UNCDF research and transactional experience, OECD data and analysis on private finance mobilized by official development finance, and a series consultations with and contributions by blended finance experts, LDC governments, UN missions, donors, civil society and research institutions. The report provides an update on the deployment of blended finance in LDCs. It also analyses its potential role in helping those countries recover from the COVID-19 crisis, and provides an Action Agenda for unlocking capital for the achievement of the SDGs in LDCs, as called for in the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda.

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