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Blending finance for climate and poverty

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Ending poverty and combating climate change: two years after the adoption of the UN Sustainable Development Goals and the Paris Climate Agreement, these interrelated challenges remain as daunting as ever, not least in developing countries. The investment required to meet the task runs into the trillions of dollars over the next 15 years, and current spending is insufficient. So how can we finance climate and development action, and as quickly as possible? A summit to check progress on fighting climate change in Paris in December focused on this very question.

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Generating the resources depends on choosing and implementing the right policies. Measures to enable climate-compatible investment, for instance, can scale up the volumes needed, while driving growth and further funds for more action. Improved fiscal policies and greater capacity to collect taxes would also help governments, as would more effort to leverage business capital to be able to finance clean transport and renewable energy as well as hospitals and schools, and other projects aimed at lifting the poorest and most vulnerable countries to a higher, more robust level of well-being. But how can the massive sums of money needed be raised?

The answer is to use development funds and financial instruments better to encourage private investment in developing countries, markets and sectors that would otherwise be considered too risky, costly or simply not relevant for businesses. This is what “blended finance” is about.

The logic is simple: a wind power project in Kenya or a public transport system in Cairo, for example, may have a sound business case but to woo unconvinced commercial investors, public support through blended finance can make the “risk-return” profile of these investments more attractive.

Blended finance is not a new concept but it certainly has returned as a new buzzword in the international development community. More than 167 donor facilities have been launched since 2000, pooling donor government resources towards blended finance approaches. Donor countries, non-governmental organisations, philanthropists and other actors all engage in blended finance. The trouble is their approaches vary, and many lack a clear strategy or guidance. It is not always clear that the finance raised is going where it needs to: into a feasible energy project that will enable poorer communities to access electricity, for instance. Of the US$81 billion in private resources mobilised by public development finance in 2012-14–through credit lines, investment in companies and funds, guarantees, and syndicated loans–only 10% of this was in least developed and other low-income countries, with the lion’s share (77%) being mobilised in middle-income countries, and the rest targeting global or regional efforts. This balance should be improved.

To help achieve more impact from such funding, OECD Blended Finance Principles were adopted by the High-Level Meeting of the OECD Development Assistance Committee (DAC) in October 2017. They are composed of five principles which together provide a common standard and set goals for what blending should deliver: anchoring the use of blended finance to a development rationale; ensuring blended finance increases the mobilisation of commercial finance; tailoring blended finance to local contexts; effective partnerships

between public and private actors; monitoring blended finance to improve transparency and ensure results.

By focusing on why, what, who, where and how, these new principles should prove useful in pushing for more donor governments and development finance providers towards the most important and crucial climate action in developing countries.

Take concessional or subsidised finance for instance. Concessional resources (such as long-term loans on favourable terms) are often necessary to mobilise additional financing, especially in countries with weak governance and regulation, or for newer technologies. But this is not always the case. The new Green Cornerstone Bond Fund, for example, uses US$325 million from the International Finance Corporation (IFC) at normal market terms to mobilise capital from institutional investors for a total fund volume of US$2 billion. The fund aims to spur the green bond market in developing countries by encouraging more local financial institutions to issue green bonds for proper market reward. The fund uses a simple two-tier structure, where the IFC takes a junior tranche, thereby cushioning the risk for institutional investors who can bank on getting a higher return. And thanks to a technical assistance grant, the IFC and the fund manager can provide training, share best practices and offer other technical assistance to local financial institutions as a way of bolstering their capacity and effectiveness.

Blended finance is not a silver bullet, but can make a difference in nudging countries forward to meet the UN Sustainable Development Goals and the Paris Climate Agreement. All countries are "investable", even poorer ones, and blended finance can help pave the way.

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