Background paper prepared by

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Blended finance for development
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INTRODUCTION

This paper reviews the state of play and the use of blended finance for development. It aims at introducing, capturing and presenting in an accessible way the key aspects of the debate on blended finance as well as discussing its potential role and limitations.

Following the definition provided in the Addis Ababa Action Agenda, this report focuses on mechanisms that **combine concessional public finance** (a subsidy in the form of official development assistance or ODA) **with non-concessional finance from either public or private sources to incentivise additional finance for development**. [1] From a theoretical point of view, blended finance combines a lot of what was already in place (i.e. non-concessional finance from actors such as development finance institutions - DFIs), with a small layer of concessional finance (i.e. ODA from donors) on top of it. It is this extra layer that makes it special as it creates a hybrid of two different worlds.

The idea and rationale behind blended finance is not new (see chapter 1), but it has only recently become an important element of the development discourse. The rise of blended finance started back in 2007 with the creation of structured mechanisms or blending platforms by the EU.[2] These platforms result from a well-defined approach and dedicated financial commitments. At the international level, the Addis Ababa Action Agenda cemented the presence of blended finance in the development agenda. Since then, it has attracted an increasing amount of attention because of its perceived potential to mobilise a large volume of finance from other actors, included the private sector.

While blended finance has gained a prominent position in development debates, there is still confusion about what blending means in practice and how and where it can work best. These are fundamental issues that should be elucidated before blending can find its right place in global development finance. This report aims at making a small contribution to move the debate forward.

Chapter 1 introduces the economic rationale behind blending. It also discusses and illustrates with examples the meaning and implications of different definitions. The final section in this chapter examines and presents some figures to put blended finance into perspective.

Chapter 2 reviews existing evidence on the strengths and weaknesses of blended finance. The chapter starts by discussing knowledge gaps. It also reviews existing evidence on the effectiveness of blended finance as a tool for development.

Chapter 3 summarises the state of play and puts forward a number of policy recommendations.

[1] See Addis Ababa Action Agenda, para. 48. The definition in the AAAA is somewhat narrower, but this is something that is addressed later in the report.

[2] The EU-Africa Infrastructure Trust Fund was created in 2007 and other EU blending facilities followed an 8 other blending facilities or platforms were launched until 2012.

1 MECHANICS, KEY CONCEPTS AND ACCOUNTING

This chapter introduces the mechanics of blended finance as well as some of the key concepts that are necessary to understand and define the boundaries of this type of finance. In the process, it discusses different definitions and illustrates them with examples. The final section discusses the accounting of blending operations and tries to shed some light onto the volume and evolution of blending operations.

1.1 MECHANICS AND DEFINITION OF BLENDING

From a theoretical point of view, the mechanics of blended finance are relatively simple. Blending uses concessional finance (i.e. a subsidy) to reduce the perceived risk of an investment, thus attracting additional finance for development (i.e. the subsidy is used to absorb a share of the risks). It can also use concessional finance to increase the development impact of project (see discussion on definitions below). This can be achieved by using ODA (as mentioned in the introduction, this report focuses on mechanisms that use ODA) in different ways, as illustrated in the table below.

Table 1. Selected instruments and the mechanics of blending

Instrument	Description – use of ODA
Investment grants	To fund specific costs and activities that decrease overall project costs and increase chances of success. These are mostly used to purchase or upgrade existing fixed capital such as tools or facilities. Some specific forms such as interest rate subsidies can help lower the costs of finance.
Technical assistance	Various uses. It can do the investor's homework, thus lowering the high transaction costs and risks for investors linked to new projects or in uncharted territories. It can also help to improve the quality of the project, for example by funding impact studies thus increasing the likelihood of success or the development impact.
Loan guarantees	To protect investors against loses and/or improve the financing costs (government guarantees reduce borrowing costs)
Structured finance—first loss piece	Absorbs risks by making the public entity the first to take on losses that may occur.
Equity investment	Equity investors take a percentage of the ownership of the company/project/fund. The money provides funding for the project, but also demonstrates viability and provides other comfort for investors.

Source: adapted from WEF-OECD (2015)[3]

There are multiple definitions of blended finance. The lack of a common definition explains to a great extent the reigning confusion around this subject and it is also the source of some of the issues addressed by this report. The different definitions have profound implications when it comes to implementing and accounting for blended finance operations. In order to avoid confusion, the introduction contains the definition which is used in the context of this report (and you can also find a sample of other definitions in annex 1).

Broadly speaking, definitions can diverge substantially when it comes to:

- **Nature of the blending element ('concessionality')**: while most definitions refer to concessional/grant-like finance (ODA), some of the definitions that can be found in the

[3] Adapted from WEF-OECD (2015). Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders. An overview of the strategic use of development finance and philanthropic funds to mobilize private capital for development. World Economic Forum

literature refer to ‘development finance’ in general and therefore include both concessional and non-concessional sources.

- **Nature of the finance combined with the blending element:** all definitions of blending generally require the combination with other sources of finance. However, some definitions only apply to the combination of public concessional finance (ODA) with private finance, while other also define as blending the combination of public concessional finance (ODA) with other non-concessional public development finance (public-public). Definitions that apply to both types of combinations do apply to much larger sets of project.
- **Mobilisation of other finance/additionality:** while some definitions of blending simply refer to the combination with other forms of finance, others reflect the idea of mobilisation of additionality (i.e. finance must be additional). As discussed below, the concept of ‘additionality’ is an important element of the debate about blended finance.

Additional complexity arises from the way ODA is deployed. Broadly speaking there are currently two big operational models for blending:[4]

I. ODA (in grant form) is combined with resources from public development finance institutions (in loan form). This is the case of the EU blending facilities, for example, which seem to be the most common.
II. ODA is used to create some form of fund that supports private investments in developing countries.[5] This is the case of the Dutch Good Growth Fund, a revolving fund that has been set up with ODA resources to support Dutch companies investing in developing countries. In comparison, this approach seems to be less common.

Problems arise under the second (II) operational model when it is used to create a fund that provides support on a non-concessional basis. For example, when the Dutch Good Growth Fund provides support to Dutch companies it does not necessarily meet the concessionality criteria (e.g. loans might not qualify as concessional loans). The bottom line is: can this model that does not necessarily involve concessional finance be considered blending? As per the broad definition proposed above, such operations should not be considered blending (unless funds are provided on a concessional basis).

1.2 KEY CONCEPTS

There are two concepts that are crucial from a methodological and theoretical point of view: ‘additionality’ and ‘leverage’ or ‘leverage ratios’.

The concept of ‘**additionality’** refers to the added value of a specific form of finance. Since we are focusing on blended finance that uses ODA, we could define additionality as ‘the unique inputs and services that the use of ODA funds provided in addition to those delivered by

[4] This is based on Pereira, J. (2017). Blended finance: what it is, how it works and how it is used. Oxfam, Research report.

[5] Please, note that if the grant is used to support public investments, it can be considered as part of the first example.

market and non-market institutions'.[6] These unique inputs and services come in two broad categories:[7]

- **Financial additionality**: blended finance is necessary to ensure the project gets finance and can be implemented.
- **Developmental additionality**: blended finance helps the project achieve better development results.

There are **strong arguments that make both types of additionality important when ODA is involved**. On the one hand, in the absence of financial additionality, the blending project is receiving a subsidy that is not necessary for it to go ahead. This could crowd out other investors. On the other hand, ODA comes from institutions with a development mandate and should always strive to improve development results. The table below discusses the implications of accounting for different types of additionality.

Table 2. Different types of additionality and implications for the project

Additionality	Financial implications	Development implications	Risks/difficulties
Financial only	Subsidy is required for project to go ahead	The development results/impact of the project can be attributed to the grant element. No changes in project design	It is difficult to estimate additionality (see discussion below)
Development only	Subsidy is not required from a financial point of view	Development results improve as a result of blended operations (better design)	Quantifying the development impact can be difficult How much improvement is required?
Development & financial	Subsidy is required for project to go ahead	The development results/impact of the project can be attributed to the grant element + Development results improve as a result of blended operations (better design)	See above
None	Unnecessary subsidy to the project	No improvement in development results	Waste of ODA resources

Measuring or evaluating additionality is essential in the context of blended finance to ensure ODA resources are not misused. There are, however, significant methodological and practical obstacles that make this difficult:

- **Financial additionality is not always defined as suggested above**. A literature review of additionality in DFI projects found that many institutions use definitions based on

[6] Pereira, J (2015) Understanding donor engagement with the private sector in development; in Business Accountability FOR Development: Mapping business liability mechanisms and donor engagement with private sector in development. CPDE in cooperation with ITUC-TUDCN and EURODAD.

[7] The OECD DAC refers to three types of additionality: financial additionality, value additionality (unique contribution of public institutions involved resulting in better development outcomes) and development additionality (increased development impacts). Both value and development additionality are included in the concept of "development additionality" used in the report as the existence of "value additionality" depends on its contribution to development results. See OECD (2016). HLM Agreement on ODA Modernisation of Private Sector Instruments - Implementation Details. DCD/DAC (2016)46

whether the investment provided access to finance on better terms, helped to access additional sources of finance, contributed to tackle the risk perceived by other investors, or the subjective perception of whether technical assistance was useful for the business.[8]

- **Similar problems also affect the measurement of developmental additionality**. Existing approaches are not comprehensive and usually look at one or a few of the following elements: improvements in project design, improvement in the projects' social and environmental standards (probably the most common), or operational aspects such as the use of specialised advice to make up for the knowledge and skills gaps in the project.[9]
- **Additionality is considered as a question with a binary answer (yes or no)**. While this might work theoretically at the financial level, in practice, projects are unlikely to either fail or go ahead. It is often possible that they go ahead in a slightly different way. When referring to development additionality, the binary answer seems even more out of place as changes to an operation's development impact need to be compared to a baseline and described (i.e. how much better is this project compared to the original version?).
- Given the complexity of the exercise, a **comprehensive evaluation framework, including both ex-ante and ex-post assessments needs to be considered**. Additionality needs to be assessed during decision-making (ex-ante), but some forms of additionality can only be accurately measured after implementation (ex-post). Too often, emphasis is made on the ex-ante assessment. This exercise often relies on self-reporting by the project applicant.[10] In addition, additionality can be best evaluated when considered in a broader framework, where the opportunity costs of using blending are compared with a set of alternatives (see below discussion in 2.1)
- Building on the above, there are **no harmonised definitions, approaches and methodologies to measure additionality**. This makes it difficult to compare and aggregates results from different projects and institutions.

A second important concept in blended finance is **'leverage'** and **'leverage ratios'**. A leverage ratio can be defined as the relationship between the amount of finance mobilised and the amount of finance that has been injected (essentially ODA or concessional finance in the context of this report).[11] A leverage ratio is thus an arithmetic ratio and can be constructed in different ways depending on the amount being compared. Below is a list of four different leverage ratios. The EU, for example, monitors the first three ratios in blending operations:[12]

- Investment leverage ratio: compares the blending grant with the total amount of investment in the project (it thus includes all actors).

[8] Pereira, J. (2015) Leveraging Aid. A literature review on the additionality of using ODA to leverage private investments. UK Aid Network, London.
[9] Ibid
[10] Pereira, J. (2017). Blended finance: what it is, how it works and how it is used. Oxfam, Research report
[11] Ibid
[12] Visser, M. et al (2017). External Evaluation of the 11th European Development Fund. Annexes, p. 157. European Commission; for information on the fourth leverage ratio see: ECA (2012) Financial instruments for SMEs co-financed by the European Regional Development. European Court of Auditors, Special Report No 2.

- Total eligible financial institution leverage ratio: compares the blending grant with the amount of finance contributed by other financial institutions involved in the project. In practice this generally refers to other support coming from multilateral or regional development banks or other development finance institutions
- Private loans/equity leverage ratio: compares the volume of blending grants with the amount of private finance involved in the project.
- Public finance leverage ratio: amount of public finance, including ODA and finance coming from other public investors, between the total amount of finance provided to the final recipients.

Leverage ratios are often used a bit inaccurately in development finance to come up with often impressive figures on investment. For example: "€3.4 billion worth of […] EU grant contributions have leveraged approximately €26.2 billion of loans by European finance institutions. […] blending helps unlock investments with an estimated volume of €57.3 billion in EU partner countries".[13] However, leverage ratios need to be looked at rather critically for a number of reasons:

- **Leverage ratios are purely arithmetic ratios and they have no implication for causality**.[14] In fact, the larger the leverage ratio the more diluted the concessional finance is in the whole project. For example, a leverage ratio of 1:20 means that the blending element represents 5% of the project finance (20% if the ratio is 1:5).
- As a consequence, **leverage ratios can provide an indication of leverage effect, only when additionality can be demonstrated**. They can never be used as an indicator of financial additionality as it is sometimes the case. Similarly, a large leverage ratio cannot be used to justify greater impact of compared projects unless additionality is accounted for.
- Leverage ratios, even when combined with additionality, **use a binary definition of the later concept (yes or no; all or nothing)**. As discussed above, a more nuanced approach would be would be more consequent with the reality of blended finance.
- **Some leverage ratios do not seem to make complete sense and involve some bold assumptions**. For example, a ratio that compares the blending grant with the amount of finance provided by public investors (in the 'total eligible financial institution leverage ratio' and in a more diluted form in the 'investment leverage ratio') suggests that the grant has leveraged public finance from DFIs, when in practice, this finance was already earmarked for development.

The uncertainties and limitations of 'leverage ratios' discussed above have profound implications for ongoing monitoring and accounting efforts. When combined with the lack of a methodology across development actors, this means that any figures on volume of funds 'leveraged' or 'mobilised' by donors and development finance institutions should be handled with care.

[13] See: https://ec.europa.eu/europeaid/policies/innovative-financial-instruments-blending/blending-operations_en

[14] ADE (2016). Evaluation of Blending. Final Report. December 2016. ADE. European Commission, 2016.

1.3 FIGURES ON BLENDED FINANCE

There are no reliable figures on the amount of ODA that is being used for blending. There are different reasons that contribute to explain this:

- The lack of a common methodology and reporting standard to report ODA flows in relation to instruments used in blending operations. The OECD has taken steps to develop new methodologies and adapt reporting templates, but there is still no final agreement on the former.[15]
- In relation to the above, the difficulties in estimating gross and net amounts. Some forms of blended finance (e.g. an equity investment) can generate inflows that would be counted as negative flows. This can happen over several years after the blended operation has been made.
- The existence of dedicated blending facilities and platforms. Contributions to these facilities and platforms is reported as an ODA grant and it is difficult to capture unless a detailed mapping of all blending facilities/platforms is conducted to complement data from other sources.
- The lack of a common definition of blending (see above), though this could be overcome if data collected is sufficiently detailed and disaggregated.[16]

The most comprehensive effort to map some aspects of blended finance is the OECD survey on the "Amounts Mobilised from the Private Sector by Official Development Finance Interventions".[17] This survey uses the OECD definition of "blended finance" that includes development finance in general and not only ODA. It also looks at the amount mobilised from the private sector only, without providing data on the volume of public finance involved. The OECD survey shows "that during 2012-2015 USD 81.1 billion was mobilised from the private sector, mainly through guarantees for which the amounts mobilised represented 44% of the total."

Efforts to estimate the amount of ODA used for blending operations often rely on the analysis of the nature of the financial flow.[18] However, this approach fails to capture ODA contribution made to dedicated blending facilities or platforms, which is reported as a simple grant and much more difficult to isolate in big datasets. This is a major flaw as the amount of ODA channelled through these platforms is probably much larger than the amount channelled by donors directly. For example, the EU Institutions alone injected approximately €2bn in its

[15] The methodology is still being negotiated. The latest official document is OECD (2016). HLM Agreement on ODA Modernisation of Private Sector Instruments - Implementation Details. DCD/DAC (2016)46

[16] P. 26 in Development Initiatives (2016). The role of blended finance in the 2030 Agenda. Setting out an analytical approach. Development Initiatives, July 2016

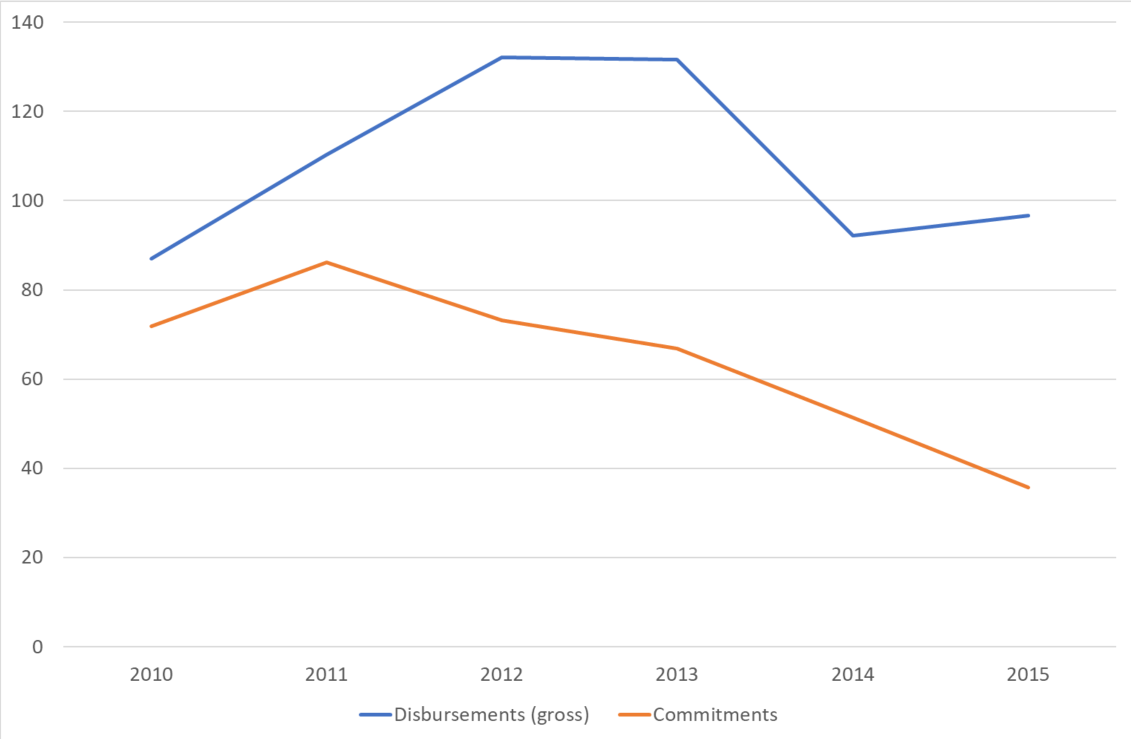
[17] Benn, J.; Sangare, C. & Hos, T. (2017). Amounts Mobilised from the Private Sector by Official Development Finance Interventions. Guarantees, syndicated loans, shares in collective investment vehicles, direct investment in companies and credit lines. OECD Development Co-Operation Working Paper 36

[18] See, for example: Pereira, J (2015) Understanding donor engagement with the private sector in development; in Business Accountability FOR Development: Mapping business liability mechanisms and donor engagement with private sector in development. CPDE in cooperation with ITUC-TUDCN and EURODAD.

blending facilities in the period 2007-2014 of which €1.7bn was contracted at the end of the period.[19]

In addition, the changes in the OECD reporting guidelines and templates have rendered the analysis more difficult even if reliability seems to have improved for some donors reporting flows (Austria, Belgium, Denmark, Germany, Norway, Portugal, Sweden, Switzerland, United Kingdom, Finland and Spain). In some cases, reporting is patchy and the figures involved very small. The figure below shows the aggregates among measured both in commitments and gross disbursements. This figure confirms that the amount of ODA for blending channelled directly by bilateral donors (i.e. not through dedicated platforms or facilities) is very small.

Figure 1. ODA for blending, selected donors, USDm 2015 constant



Source: author

2 LIMITATIONS AND POTENTIAL OF BLENDING

This section discusses the potential and limitations of blended finance. This is no easy task as there is a significant lack of hard evidence in the form of independent evaluations and research reports looking across a significant sample of projects.[20] To date, the only comprehensive evaluation available is the evaluation of the EU blending facilities released at the end of 2016.[21] It covers the period 2007-2014. These and other sources of evidence will be referred to were relevant in the lines below. It might be possible to draw some lessons from existing

[19] ADE (2016). Evaluation of Blending. Final Report. December 2016. ADE. European Commission, 2016.
[20] Bilal, S. & Große-Puppendahl, S. (2016). Blending 2.0. Towards new (European External) Investment Plans. Ecdpm discussion paper no 207, December 2016.
[21] ADE (2016). Evaluation of Blending. Final Report. December 2016. ADE. European Commission, 2016

literature on the use of public subsidies to promote private investments, but that would require an extensive discussion that is beyond the scope of this report.

This chapter is divided into two sections. The first section discusses the potential and limitations of blending as an approach to development. To do so it tries to focus on the basic mechanics of blending and to explore its implications, using existing evidence when available. The second section raises a number of questions, not from the theory behind blending but from the practical and methodological aspects related to its implementation

2.1 LIMITATIONS AND POTENTIAL OF BLENDING AS AN APPROACH TO DEVELOPMENT

In the absence of more substantial evidence about blending, the discussion about the limitations and potential of blending remains at a very theoretical level. Below is a summary of some of the key issues currently on the table. Given the limitations and scope of this paper, the focus is at the strategic level.

Blending is a tool to address market failures but there is not necessarily a lot of space or demand for it to operate. Blending as defined in this report involves the use of a subsidy to incentivise investment in developing countries and/or increase the development impact of a project. From an economic point of view, a blending grant is justified if it tries to address some form of market failure thus unlocking or boosting the potential of a development project.[22]

When one sees blending as a tool to address market failures, it is important to consider the context where it operates. Assuming we are under the first and most common operational model (a blending grant is combined with resources from public development finance institutions), blending might only be justified in a small number of cases. DFIs already have a development mandate and have been designed to address some of the market failures of working in developing countries. There might be some space for blending in this context, but this should not be necessarily large nor common (i.e. market failures should not be very common among DFIs). Also, one should consider whether blending is needed because of the existence of a real failure (something the institution cannot cover, i.e. an operation with too much risk for a DFI but with a large development impact potential that justifies the ODA grant) or whether it is due to weaknesses in the design of the project and could be addressed in some other way. Under the second operational model, where blending targets the private sector directly, there should be more scope to address market failures, but only when the operations are concessional in nature. In this particular context, it is also very important that blending operations take into account potential market distortion and crowding out effects, in particular in relation to local investors.[23]

In relation to the above, **blending should be considered within a clear country framework**. As discussed above, blending is designed to address market failures. These are often country specific and require specific actions. When operating at a country context, it becomes essential

[22] For example: a blending grant can help absorb or reduce the risks of other investors, fund technical assistance to reduce information asymmetries or increase the development impact of project by financing a small investment within the project that might benefit many people, but which is not provides small returns to be interesting in the first place (e.g. connecting local populations along a major power line).

[23] Development Initiatives (2016). The role of blended finance in the 2030 Agenda. Setting out an analytical approach. Development Initiatives, July 2016

to ensure coordination with industrial policies as well as the participatory design and decision-making processes (more on this in the paragraphs on a 'principled approach' below). If blending is essentially done and managed by donor countries with a view to supporting the private sector, there is a significant risk of it resulting in some form of tying (i.e. to use it to support its own interests or companies).

To properly evaluate blending it is important to consider the opportunity costs both at the project level and within the broader context of development finance. This means considering whether: i) a subsidy is the best option for this project; and ii) a blending operation is the best possible use of ODA compared to other alternatives. This is important to ensure blending is not a zero-sum game (i.e. the gains of an individual project are not balanced by loses somewhere else) and to define the place and role of blending within development finance. This requires better data and information in order to understand blending and ensure it is used only when necessary. This is why addressing the methodological and technical gaps listed in the following section is essential.

Blending is often portrayed as a tool to leverage additional private investment, but there is limited evidence showing whether and how this can be best achieved and what models work best. An independent evaluation of EU blending operations shows that blending can leverage private sector investments, but this was not the case for most of the projects explored in the sample.[24] In comparison, it seems that the EU blending facilities made more emphasis on supporting or collaborating with other public investors. The lack of independent evaluations and evidence, makes it difficult to assess other operational models. Interestingly, the recently approved European Fund for Sustainable Development (EFSD) combines existing blending facilities with a Guarantee Fund that targets the private sector directly. The guarantee fund is not funded with ODA resources, but the fact that the EU had to complement existing facilities with an instrument targeting the private sector indicates a gap left by the blending facilities that needed to be filled.

Additionality should be qualified when blending is used in combination with public finance for development. While blending can help unblock finance for a specific project,[25] the overall budget of DFIs involved in blending projects is not affected by a blending project and the total amount of resources for development remains the same. As a consequence, one could talk of 'project additionality', but it is **more difficult to claim that blending leverages additional public finance for development.**

In this context, **a principled approach to blending does make sense** as a way to ensure blended finance is deployed in the most effective way to address the needs of developing countries. It seems logical that the development effectiveness principles should be the starting point of this reflection.[26] The Addis Ababa Agenda for Action already contains a set of principles that should guide blended finance and that echo many aspects of the development effectiveness agenda.[27] The OECD DAC is currently discussing a set of principles to blended

[24] ADE (2016). Evaluation of Blending. Final Report. December 2016. ADE. European Commission, 2016
[25] As it is the case of some projects described in ADE (2016). Evaluation of Blending. Final Report. December 2016. ADE. European Commission, 2016
[26] 'Development effectiveness principles' refers to the aid and development effectiveness agenda development at the conferences in Paris, Accra and Busan.
[27] See P. 19, Inter-agency Task Force on Financing for Development (2017). Financing for Development: Progress and Prospects. United Nations, New York

finance, though they have not been made public when this report was written. Even if not all principled might be directly applicable or there might be specific challenges arising from the hybrid nature of blending operations (concessional finance and non-concessional finance, often with a focus on the private sector), several development effectiveness principles still make sense. For example, even if the target is the private sector, it still makes sense to coordinate or align support with national strategies and industrial policies. This would require developing approaches to blending that consistently involve stakeholders from developing countries in decision-making. Current approaches do not have inclusive decision-making structures[28] which means it can be difficult to ensure consultative processes across all projects. Openness and inclusiveness are also important to ensure adequate accountability to people affected by blending projects. It is generally difficult to identify blended projects supported through ODA which makes accountability processes difficult.[29]

2.2 CONSTRAINTS AND CHALLENGES ARISING FROM METHODOLOGICAL GAPS

A second set of limitations arise not from the theory and the mechanics of blending but from the practical and methodological aspects related to its implementation. Previous pages have already identified the following issues and described its direct implications: lack of a common definition of blending, lack of a common definition and approach to evaluate additionality; lack of a common approach to report blending operations and ODA contributions. Additional analysis and information on data needs and gaps, and how these can be improved can be found in a report from Development Initiatives.[30] This section discusses some of the challenges and limitations that should be dealt with when trying to fill these gaps.

Different actors participating in blending project might claim to have leveraged other forms of finance, thus providing an inflated view of the actual leverage effect. Current accounting approaches descriptions do not offer an objective view of who has leveraged who and what funds.[31] A solution to this problem requires, as a starting point, agreeing a common definition and methodology to define additionality and testing projects against it. A second step would be to a common methodology that provides distributive and realistic view of leveraged/mobilised finance. For example, one could look of public finance to private finance and seek a way to split it among different public investors.

There is a risk of creating intended or unintended incentives that could steer blended finance in a given direction or divert ODA from other uses. This is a complex but extremely important issue that is linked to the way concessionally is measured. The discussion is currently under

[28] Pereira, J. (2017). Blended finance: what it is, how it works and how it is used. Oxfam, Research report

[29] This question is addressed for the EU blending facilities in Bilal, S. & Große-Puppendahl, S. (2016). Blending 2.0. Towards new (European External) Investment Plans. Ecdpm discussion paper no 207, December 2016. A more general discussion can be found in Pereira, J. (2017). Blended finance: what it is, how it works and how it is used. Oxfam, Research report

[30] Development Initiatives (2016). Blended finance: Understanding its potential for Agenda 2030. Development Initiatives, November 2016

[31] A more detailed description of the different approaches and some of the ongoing discussions can be found in Benn, J.; Sangare, C. & Hos, T. (2017). Amounts Mobilised from the Private Sector by Official Development Finance Interventions. Guarantees, syndicated loans, shares in collective investment vehicles, direct investment in companies and credit lines. OECD Development Co-Operation Working Paper 36

way at the OECD DAC, but a final agreement has not been reached at the time of writing.[32] Despite the technical complexity involved, there are a couple of issues that are important to mention in this report.

Developing a different approach to measuring concessionality could provide incentives to decrease the number of grants. Certain types of flows such as guarantees require a different approach to measuring concessionality. Unlike a grant, which is essentially a subsidy, a guarantee might or might not be called in. Firstly, it can lead to a reassessment of the global portfolio of guarantees for development in the short term, resulting in a sudden increase of ODA flows. The volume of the increase would depend on the methodology that is used. Secondly, if the approach is not carefully tuned, the possibility of reporting certain financial flows such as guarantees, which might entail a smaller financial cost on the donor side, could provide an incentive to reduce the amount of ODA grants and increase the amounts of ODA going to blended finance (e.g. when for the same ODA reportable amount, a guarantee has a lower financial cost than a grant). This effect would mainly be felt in the longer term.

Discount rates are another sensitive element of concessionality estimates that deserves more attention. A discount rate allows to estimate the net present value of future payments and has an important impact on the level of concessionality. Its value depends on underlying factors such as inflation and risk that can be difficult to estimate in the first place. For the same operation, the higher the rate of discount the lower the total grant element in a financial operation.[33] The proposal the OECD put on the table at the end of 2016,[34] shows a substantial gap in the discount rates applicable to operations different countries (LDCs + LICs: 6%; LMICs: 4%; UMICs: 3%, with another proposal suggesting 1% for UMICs).[35] If the difference in the values is not well adjusted, this approach in which UMICs offer lower discount rates these set of countries could attract more blended finance operations since, all other variables of the project being equal, they provide the opportunity of reporting higher ODA flows. Also, while there are strong arguments for using a simplified approach with harmonised discount rates per income group, there also are extreme differences of the underlying economic and political realities, which could lead to important distortions within income groups (i.e. same discount rate for similar operations but with different political or economic risk profiles in practice).

In order to avoid this kind of distortions in financial flows or undesirable effects, it is important to have a transparent and evidence based discussion on how to estimate the concessionality levels of different types of flows. Right now, it is not clear the evidence behind the OECD DAC discussions and it is very difficult to model the effects of the existing proposals due to the lack of access to the required datasets. For example, detailed data on the nature and composition of guarantee portfolios is not available on the public demand as export credit agencies and other institutions involved generally treat the information as confidential for commercial reasons.

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[32] OECD (2016). HLM Agreement on ODA Modernisation of Private Sector Instruments - Implementation Details. DCD/DAC (2016)46

[33] This is because the present value of future payments is smaller. The effect can be very significant in longer financial operations (10-20 years).

[34] OECD (2016). HLM Agreement on ODA Modernisation of Private Sector Instruments - Implementation Details. DCD/DAC (2016)46

[35] Ibid and Non-public documents: Joint Proposal from Spain and the United States: Advancing the work on Private Sector Instruments (PSI). 7 November 2016; and Note with comments received from Task force members on the solution matrix circulated on 21 February 2017.

Finally, it is also important to pose the question of whether the OECD DAC is the right body where discussions should take place and decisions taken. Even if blending uses concessional finance from donor countries, it affects and targets developing countries. It seems thus reasonable that developing countries are involved in any discussions related to the definition, frameworks or methodological approaches and data and information needs surrounding the use of blended finance. In this context, and without questioning the technical capacity of the OECD DAC, one could argue that OECD does not provides the most adequate arena for such a debate from a political and participatory point of view.

3 CONCLUSIONS AND POLICY RECOMMENDATIONS

This paper has reviewed the current state of the debate on blended finance and has identified important areas and gaps which could affect its impact or have spill over effects on concessional development finance flows. The aim was twofold: to introduce and explain blending, while providing a stepping stone for helping the debate move forward. The motivation in the long term, is to ensure blended finance is uses in a way that maximises the impact of development finance flows, including concessional ODA. The conclusion of this paper can be groups in two broad sets of issues.

What needs to be done. This is essentially a research agenda with different areas that deserve additional attention and are key to maximise the impact of blended finance, both by itself and in the broader context of development finance. The following issues should be addressed as soon as possible:

- A common definition of blending that avoids unnecessary confusion and serves as a basis for a reporting system.
- A common reporting system for blending projects, that provides a good picture of blending operations per donor and avoids any form of double counting both in relation to ODA flows and to the amounts claimed as mobilised. The data should be available in the public domain to ensure access by project stakeholders, academics, civil society and others.
- A common definition of additionality that considers its different aspects: financial and developmental (potentially the later could be broken down into smaller elements). This should be coupled with a common methodological framework to evaluate it on an ex-ante and ex-post basis.
- An open methodology to estimate the concessionality of blending elements (including discount rates) that does not create any distortions in ODA and development finance flows. This is a very complex issue that requires and open and honest debate. Most likely, it will also involve some form of trial and error approach before experts can get it right.
- A concerted effort to undertake independent evaluations of blending operations and make the results public. Such efforts should provide the foundations of a much-needed body of evidence that should help understand the potential and limitations of blended finance and contribute to move the discussion forward.

How the process should look like. This is a more strategic question that relates to the framework where conversations should take place and how decisions are made.

- There is a need to make the debate more inclusive and involve additional stakeholders. Right now, most discussion are being conducted within the OECD DAC and among a limited set of stakeholders. In most cases information made available once a decision has been adopted. As a result, current format used by the OECD DAC might not be the adequate for such a debate.
- Use an evidence based approach when dealing with the technical questions. The decisions on how to report and account for blending flows could have a significant impact on ODA and development finance flows. Any decisions should be informed by enough evidence and debate.

- Adopt a principled-based approach to blended finance, including the technical aspects of the debate. Transparency, participatory approaches are essential in all stages of the debate including the methodological aspects. As discussed above, ownerships and other development effectiveness principles should also play a role in when it comes to project design. The discussion should probably start with development effectiveness principles.

ANNEX I. SAMPLE DEFINITIONS OF BLENDING

Below is a list of sample definition that help to inform the discussion in chapter 1. Some definitions that are broader than the original scope described in the introduction, but are essential to understand the debate:

1. Blended finance is the strategic use of development finance for the mobilisation of additional commercial finance towards the Sustainable Development Goals (SDGs) in developing countries.[36]
2. Blended finance […] combines concessional public finance with non-concessional private finance and expertise from the public and private sector. [37]
3. [Blended finance is the] complementary use of grants (or grant-equivalent instruments) and non-grant financing from private and/or public sources to provide financing on terms that would make projects financially viable and/or financially sustainable.[38]
4. instruments that blend public and private financing and that support private sector projects.[39]

[36] OECD formal definition, see: http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/blended-finance.htm
[37] Addis Ababa Action Agenda, para. 48
[38] Mustapha, S.; Prizzon, A.; Gavas, M. (2014) Topic Guide: Blended finance for infrastructure and low-carbon development. Evidence on Demand, UK
[39] UN-DESA (2015). Workshop in preparation for the Third International Conference on Financing for Development: the role of catalytic aid in financing sustainable development. DCF Republic of Korea High-level Symposium