Background Paper Commissioned by the United Nations Conference on Trade and Development for *The Least Developed Countries Report 2019*

Private Sector Engagement in LDCs: Challenges and Gaps

Anna Abalkina, Yury Zaytsev

Updated in 2021 with inputs provided by UNCTAD

Content

Abbreviations

AAAA	Addis Ababa Action Agenda
AfDB	African Development Bank
AsDB	Asian Development Bank
AUM	Assets under management
CABEI	Central American Bank for Economic Integration
CAF	Andean Development Corporation
CIV	Collective investment vehicle
CSR	Corporate social responsibility
DAC	OECD Development Assistance Committee
DFI	Development finance institution
EADB	East African Development Bank
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
FDI	Foreign direct investment
GDP	Gross domestic product
GIIN	Global Impact Investing Network
GRI	Global reporting initiative
HIPC	Heavily indebted poor countries
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IDB	Islamic Development Bank
IDC	International development cooperation
IFC	International Finance Corporation
IMF	International Monetary Fund
LDCs	Least developed countries
MDBs	Multilateral development banks
MIGA	Multilateral Investment Guarantee Agency
OECD	Organisation for Economic Co-operation and Development
PPP	Public-private partnership
PSE	Private sector engagement
SCM	Subsidies and countervailing measures
SDGs	Sustainable development goals
SPV	Special purpose vehicle
WTO	World Trade Organization

Introduction

The private sector was proclaimed by the Addis Ababa Action Agenda as an important actor in development cooperation and the implementation of Agenda 2030. The private sector is considered to be a source of additional capital together with official development flows in order to achieve the SDGs.
The ambitious goal to engage private capital raises a series of questions on the potential of the private sector to contribute to the "from billions to trillions" agenda. Thus, considerable uncertainty remains that private capital can match or surpass the volume of official development flows. There is also growing concern about the developmental impact of private sector engagement, especially in low income countries. There is still little evidence and knowledge on the efficiency of private sector instruments and private sector capital allocation, including its interactions with profit expectations and the attendant risks for achieving desired development outcomes. Though the role of private sector should not be discounted its contribution to structural transformation in the Least Developed Countries (LDCs) warrants further analysis.

The purpose of this paper is to summarize what is known about engagement with the private sector for development before and after the Agenda 2030, and to analyse the post-2015 development cooperation framework on private development finance with a view to gaining insight on the problems associated with private sector engagement in the least developed countries (LDCs).

Structure

This paper is subdivided into seven sections. The first section summarizes the differences between commercial capital and development finance. The second section gives an overview involvement by donors of the private sector in development cooperation before the Agenda 2030. The third section discusses typologies and forms of private sector engagement in the implementation of the Agenda 2030. Section four discusses the issue of the 'subsidisation' of the private sector in development cooperation. Section five evaluates the modernization of the OECD Development Assistance Committee (DAC) rules on official development assistance and its monitoring of private sector instruments and private sector engagement. Section six focuses on the dynamics and distribution of private sector engagement in LDCs in 2012-2018 by beneficiary country, donor, instruments, sector and purpose. Section seven summarizes the challenges and gaps of the post-2015 development cooperation framework in LDCs with a special emphasis on public-private initiatives, mobilization and channeling of finance, and the challenges of evaluating developmental impact.

About the authors

Anna Abalkina is a research fellow at the Ludwig Maximilian University of Munich (Germany). She holds a candidate of sciences degree from the Financial Academy under the Government of the Russian Federation (Russia) and a Ph.D. degree from the University of Perugia (Italy).

Yury Zaytsev is a senior research fellow at the Russian Academy of National Economy and Public Administration (Russia) and MA student at HTW University of Applied Sciences Berlin (Germany). He received a candidate of sciences degree from MGIMO University (Russia).

Anna Abalkina contributed to all sections of the paper, **Yury Zaytsev** contributed to Sections 2, 4, 7.1 and the concluding remarks.

The paper was submitted in June 2019 and updated in September 2020.

Acknowledgments

The authors would like to thank Gaya Oganesyan and Matfobhi Riba for their technical expert contributions.

1. Private development finance vs private commercial capital

The current volume of official development assistance is not sufficient to cover the capital gap for the implementation of the SDGs, which is estimated at $2,5 - $3 trillion annually[1]. There is no expectation of a significant increase in official development assistance (ODA) provided by bilateral and multilateral donors to developing countries in the future. Consequently, the Monterrey Consensus[2] and the Addis Ababa Action Agenda[3] affirm a leading role to private capital to close the investment gap.

Participation of private capital in low-income countries is limited due to their perceived elevated risk environment and low profitability for commercial investments. This places LDCs at a disadvantage because the fundamental purpose of commercial capital is profit-seeking. Commercially oriented private business generally does not pursue development goals but contributes to economic development and growth by its activities and investments.

The main distinguishing features of private commercial capital and private development finance are summarized in the following table:

Commercial capital	Private development finance
Profit-oriented but may unilaterally set additional social or philanthropic goals	Private capital engaged for development purposes
Derives profits from bankable investment projects	Profitability "subsidized" by official flows and applies the principle of additionality[4] and seeks developmental impact
Allocated without geographical limits	Disbursed to ODA eligible countries
	Development cooperation actor in the implementation of Agenda 2030

Commercial private capital could contribute to financing the SDGs through donors' blended finance mechanisms. The objective of donors' blended finance mechanisms is to create conditions and facilities to channel capital from private actors and institutional investors (banks, investment companies, pension funds, insurance companies, equity funds, etc.) for development purposes. Blended finance mechanisms are thus intended to direct or nudge private commercial flows to finance projects with developmental outcomes.

2. Modalities of private sector engagement before the Agenda 2030

Multilateral development banks (MDBs)

The Monterrey consensus proclaimed the MDBs as one of the leading sources of development finance. They are international treaty institutions that lend mainly to their shareholders (governments), and they lend for development purposes rather than to make a profit. They have multiplied in number and their roles have been the subject of multiple reassessments since they were first created.[5] MDBs provide financing for projects most frequently in hard currency and for longer terms than commercial lenders, who may not offer sufficient length or amount. However, compared to commercial banks, MDBs have been criticized as taking an extremely conservative approach to capital adequacy[6].

The Addis Ababa Action Agenda confirmed the important role of the MDBs in development finance and encouraged them to increase long-term lending in domestic currencies to developing countries given the potential for serious dysfunctions[7] generated by external indebtedness and foreign currency based financing for developing country public sectors. Most MDBs started to engage in local currency lending

1 UNCTAD (2014). World Investment Report.

2 Monterrey Consensus on Financing for Development adopted at the International Conference on Financing for Development Monterrey, Mexico, 18-22 March 2002

3 Addis Ababa Action Agenda of the Third International Conference on Financing for Development, Ethiopia, 13–16 July 2015

4 Provided as a necessary addition to, rather than as a replacement of commercial private investment.

5 See, for example Wang H. New Multilateral Development Banks: Opportunities and Challenges for Global Governance. Global policy, Vol. 8, Issue 1, 113-118; Kellerman, M. The proliferation of multilateral development banks. The Review of International Organizations 14, 107–145 (2019). https://doi.org/10.1007/s11558-018-9302-y

6 Humphrey C. (2017). He Who Pays the Piper Calls the Tune: Credit Rating Agencies and Multilateral Development Banks. Review of International Organizations, 12, 281–306; Humphrey C. (2020). All hands on deck: How to scale up multilateral financing to face the Covid-19 crisis. Emerging analysis and ideas. Overseas Development Institute (ODI). London.

7 Bresser-Pereira L.C. and Bechelaine C. (2019). Multilateral development banks, new developmentalism and local currency financing. Brazilian Journal of Political Economy. 39, 4, 755-767. DOI: https://doi.org/10.1590/0101-31572019-2980.

in the 1990s under their private sector operations through the issuance of local currency bonds that have attracted private institutional investors (commercial banks, investment, and insurance companies, welfare funds). These bonds appeal to private institutional investors faced with shallow and underdeveloped domestic financial markets in developing countries.

The 2017 G20 Hamburg Principles endorsed the target to increase the MDB's mobilization of private capital by 25 to 35 percent by 2020. A focus on mobilizing private finance for development is not new for the MDBs as this is by design the natural activity of their private sector operations (or windows) and is part of their mandate to help bridge the gap between clearly public and obviously commercial projects with potential development impact. MDBs were intended to have different motivations than private lenders to the extent to which they select projects that maximize the expected development impact. Besides, their investment decisions are supposed to be driven by the explicit aim of mobilizing domestic and foreign capital. That said, their track record of implementation of this mandate is controversial. Among criticisms are perceived tendencies to adopt an 'investment climate approach' to the private sector that prioritises attracting foreign investment; banking models that focus activities in areas already favoured by investors; and the tendency to generate and use knowledge products with the aim to reinforce their established practice.

Multilateral development banks (MDBs) have always engaged with the private sector as capital providers[8] as part of their role as financial intermediaries that borrow from international financial markets and extend long term loans, guarantees, equity investments primarily for large government-led investment projects and policy reform-based programs in beneficiary countries. Most MDBs' operations are highly concentrated in economic infrastructure. The volume of financing committed to infrastructure by the MDBs[9] doubled between 2005 and 2014. They are among the largest issuers of long-term debt instruments in international capital markets and the debt instruments they issue (mainly long-term bonds) carry the highest available credit ratings–most MDBs have a credit rating of AAA for their hard windows. By pooling risk among rich and poor country shareholders, MDBs can borrow cheaply on international financial markets, and hence on-lend to borrowing governments at low-interest rates with enough margin left over to pay for administrative overhead.

MDBs thus lower the cost and insulate from capital market volatility those recipients for which access to private capital can be unreliable, limited, and costly on account of their being perceived by private lenders to be of high credit risk. Consequently, low-income countries, including LDCs have traditionally relied much more on the support from development partners than other developing countries, due to their lower capacity to mobilize domestic and external private finance. Nevertheless, before 2015, most infrastructure spending was provided by developing country governments, about a third by the private sector, and only a small portion by development partners (including MDBs) but LDCs received a fraction of the resources flowing to developing countries from the private sector and development partners.[10] MDBs' on-lending is not generally subsidized, with a larger share of MDBs' annual lending operations not classified as ODA. However, MDBs have special windows for concessional operations through which they provide grants and loans at below-market-rate interest rates to low-income countries. In the case of MDBs (such as the African Development Bank) that service many borrowing countries that are eligible for concessional borrowing only, a greater proportion of their operations are eligible for classification as ODA.

MDBs' private sector operations apply a broad range of instruments, including grants, loans, lines of credit, technical assistance, and equity. Blending approaches are a traditional feature, including risk-sharing tools to help crowd in private finance built into private sector operations from the start. Notwithstanding, some tools have a poor track record of being used by the private sector and MDBs, as evidenced by the fact that guarantees typically represent a very small share of MDB portfolios. Some MDBs have progressively introduced private sector instruments that do not require government guarantees. For example, in 1995 the Inter-American Development Bank began to target up to 5 percent of its ordinary capital resources in direct loans for private sector projects without a government guarantee.[11] MDB direct private sector investments increased fourfold during the MDG implementation period.[12] In 2014, MDBs disbursed two thirds of their non-concessional flows for infrastructure in direct financing to the private sector.

8 The private sector can be a source of commercial finance (e.g. corporates undertaking FDI) or a provider of capital when active in international (and domestic) capital/financial markets.

9 Applicable African Development Bank (AfDB), Asian Development Bank (AsDB), Development Bank of Latin America (CAF), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Inter-American Development Bank Group (IADB), Islamic Development Bank (IsDB), and the World Bank Group (WBG) operations.

10 https://www.cbd.int/financial/doc/oecd-oda-infrastructure.pdf

11 Inter-American development bank (2002).

12 https://www.un.org/esa/ffd/wp-content/uploads/2016/01/Multilateral-Development-Banks_WBG_IATF-Issue-Brief.pdf

The private sector windows of all the major MDBs have targeted increasing syndication activity, but success has been modest and further efforts are merited, particularly at the regional MDBs (AfDB, ADB, and IDB).

Table 2.1 - **MDB Private Sector Financing* (beginning of the 2000s)**

MDB	Private sector financing, %	MDB	Private sector financing, %
EADB	100.0	CAF	12.3
EBRD	79.5	AfDB	5.2
EIB	43.4	IADB	3.0
CABEI	36.5	AsDB	2.8
IDB	24.5	IBRD	1.2

* Private Sector financing (Outstanding gross loans, equity investments, outstanding guarantees) /Total financing (%)
Source: Multilateral Development Banks: Rating Criteria and Industry Review. – Paris: Fitch Ratings, 2005. P.3.

Loan instruments are among MDBs' more favoured blended instruments with other instruments far less common across the MDB system. Private sector beneficiary projects are provided partial financing, with additional financing raised by the beneficiary as part of a joint financing approach. and. In this context, MDBs have developed networks of partner commercial banks. Partial financing typically differs from project co-financing and syndication, which are directly linked to MDB resource mobilization strategies. There is some evidence that MDBs' lending can give a positive signal to markets and promote private flows to beneficiary countries.[13] Compared to private-sector lending, MDBs' operations are counter-cycle[14], albeit the evidence also suggests that this can vary by region[15].

MDBs have supported and developed the private sector by equity operations often through investments in strategic financial sector actors. MDB equity operations are often interpreted by markets as an endorsement of the good governance of the beneficiary company[16]. For example, MDBs provide microfinancing instruments for financial intermediaries in recipient countries to promote access of SMEs to financial resources. In LDCs MDBs use a variety of financial institutions as intermediaries to reach and promote loans to micro, small and medium-sized enterprises that are typically too small for servicing through regular MDBs financing operations[17].

With 70% of private sector operations concentrated among 10 emerging nations, operations by MDBs, especially the World Bank, have been criticized for lending mainly to middle-income countries that already enjoy access to international capital markets[18]. Since 1993, the share of IBRD loans to countries without international rating fell from 40% to 1% in 2001-2005[19]. MDBs' commitment to the additionality principle is also questioned for the same reasons because true additionality is achieved only in the poorest countries. In beneficiary middle-income countries, private commercial banks are typically better placed to finance projects and there is less need for official guarantee[20].

Bilateral donors

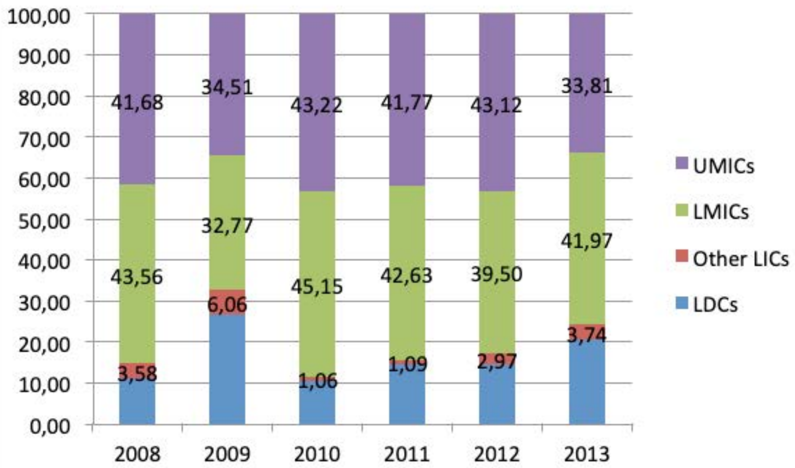
All bilateral donors consider the private sector as the

13 Birdsall N., Brian D. (2001). Multilateral Development Banks in a Changing Global Economy. Economic Perspectives. Electronic Journal of the U.S. Department of State.
14 Addis Ababa Action Agenda (2015).
15 Galindo A.,Panizza U. (2018). The cyclicality of international public sector borrowing in developing countries: Does the lender matter?, World Development, Vol. 112(C), 119-135.
16 IFC (2002). IFC and its role in globalization.
17 IFC (2018). Understanding DFIs' Private Sector Engagement in African Fragile and Conflict-Affected Situations. P.22
18 Meltzer, A. (2000). Report of the International Financial Institution Advisory Commission. Prepared for the U.S. Congress. Washington, DC.; Lerrick, A. (2006). Has the World Bank Lost Control? In Rescuing the World Bank: A CGD Working Group Report & Selected Essays, ed. Nancy Birdsall, pp. 117– 132. Washington, DC.: Center for Global Development. Available at http://www.cgdev.org/content/general/detail/9957 (accessed 2020, 16 November).
19 Lerrick, A. (2006). Has the World Bank Lost Control? In Rescuing the World Bank: A CGD Working Group Report & Selected Essays, ed. Nancy Birdsall, pp. 117– 132. Washington, DC.: Center for Global Development. Available at http://www.cgdev.org/content/general/detail/9957 (accessed 2020, 16 November).
20 Meltzer, A. (2000). Report of the International Financial Institution Advisory Commission. Prepared for the U.S. Congress. Washington, DC.

engine for development and economic growth and several have operationalized frameworks for private sector engagement and priorities. Donor strategies on private sector development are characterized by different degrees of elaboration of priorities and targets[21] but similar to the MDBs, bilateral donors allocate most flows for private sector development to middle-income countries (see Figure 2.1). The sector that is engaged most of all is the financial sector. Industry and energy generation and supply are also among priority sectors.

The allocation of bilateral aid is more influenced by political issues[22] and tied aid remains a significant issue for development effectiveness. According to OECD untied aid to LDC/HIPC countries accounted for 76% of all aid flows in 2016[23].

Figure 2.1 - **National financial institutions' support for the private sector in developing countries (%)**



Source: OECD(https://public.tableau.com/views/NONODA_DFIs/DFIs_EN?:embed=y&:display_count=no ?&:showVizHome=no#1)

UN organizations

Direct cooperation between the private sector and the United Nations was traditionally viewed with skepticism because of concerns around protecting the image, reputation and values of the United Nations. Although present since the UN's inception, it emerged as a significant phenomenon in the late 1990s in response to the complexity of global problems, the scarcity of resources, and the failure of multilateral mechanisms to address these issues[24]. Since the adoption of the Millennium Development Goals and the Monterrey Consensus, partnership with the private sector as a means of implementing United Nations objectives has been increasingly recognized by the Member States who increasingly stressed the importance of private investment in development. Milestone initiatives include the United Nations Global Compact, a non-binding pact to encourage businesses worldwide to adopt sustainable and socially responsible policies, launched in 2000, and the Guidelines[25] on cooperation between the UN and business. Since 2005, the UN has organized private sector focal points' meetings[26] and private sector forums to build a closer partnership with private business.

Corporate social responsibility links to development cooperation

Business frequently positions its corporate social responsibility (CSR) practices as an entry point for its contributions to development goals in developing countries. This link is strengthened when running the business assumes prior compliance with social and environmental commitments is a contractual obligation or condition for obtaining the license to operate. From the business perspective, CSR projects are launched to develop and maintain client loyalty but

---

21 Kindornay S., Reilly-King F. (2013). Investing in the business of development. The North – South Institute. Canada.
22 Gulrajani, N. (2015) Bilateral versus multilateral aid channels: Strategic choices for donors. ODI Working Paper. London.
23 OECD (2018). Report on the DAC untying recommendation.
24 United Nations, (2010). Coming of age: UN-private sector collaboration since 2000. United Nations Global Compact Office. New York.
25 Guidelines on a Principle-based Approach to the Cooperation between the United Nations and the Business Sector. The Guidelines were first issued in 2000, revised and reissued in 2009, and further revised in 2015 as requested by GA Resolution A/RES/68/234.
26 UN-Business Focal Point Newsletter Issue 16 (November 2011). URL: https://business.un.org/en/documents/10252

also to obtain athe social licence to operate in host-communities. According to one study by the CECP[27], about 40% of mining companies' CSR programs are implemented in foreign countries. This is explained by their dependence on geographical expansion for diversification and growth. Similarly, CSR projects of energy companies are mainly associated with environmental protection, health, and education. In 2018 a significant proportion of funds spent by international businesses on financed CSR projects in health and social services (27%) and community and economic development (22%).

CSR projects can complement the activity of bilateral and multilateral donors and ha increasingly been associated with the voluntary implementation of international principles on good corporate governance such as the Equator Principles, the Global reporting initiative (GRI), and the United Nations Global Compact.

Box 2.1 **– The Equator Principles**

The Equator Principles, adopted by financial institutions, establish the minimum standard for due diligence and the monitoring of adverse environmental and social consequences in project financing. Their risk management framework applies globally, across all industry sectors and covers several aspects of project finance.
Source: Equator Principles – http://www.equator-principles.com

3. From investing in private sector development to private sector engagement

The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda emphasized the need to "catalyse and scale up private financing for sustainable development". Private sector engagement became a core element in the new agenda of development financing. In 2015, the Addis Ababa Action Agenda adopted at the third International Conference on Financing for Development recognized the importance of private sources of development finance and the pursuit of innovative financing methods to mobilize additional development finance (see Table 3.1).

The development community realized that the achievement of the SDGs in developing countries required a search for new methods of financing beyond official sources or existing commercial investors because official development flows and domestic resources could not be expected to meet all the requirements of the new development agenda, especially in low-income countries.

Table 3.1 - **Post-2015 development agenda**

20-22 September 2010	**20-22 June 2012**	**30 May 2013**	**10 September 2014**	**13-16 July 2015**	**1, 15, 25-27 September 2015**
UN MDG Summit	Rio 2012	The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda	UN General Assembly	Addis Ababa Action Agenda	UN General Assembly
Mandate to Secretary-General for further steps to advance the UN development agenda beyond 2015	Concept of Sustainable development goals. Decision to constitute the working group (A 30-member Open Working Group) on SDGs.	Sustainable development Agenda. Recommendations of the working group on SDGs.	The proposals of the Open Working Group on SDGs should be discussed by international community	Framework of financing of SDGs	The adoption of the post-2015 development agenda

27 CECP (2019). Giving in Numbers. URL: https://cecp.co/home/resources/giving-in-numbers/

20-22 September 2010	20-22 June 2012	30 May 2013	10 September 2014	13-16 July 2015	1, 15, 25-27 September 2015
		The document proposed to use official resources to "catalyse and scale up private financing for sustainable development	The working group proposed to "strengthen domestic resource mobilization" and to "mobilize additional financial resources for developing countries from multiple sources"	AAAA recognized the importance of FDI, remittances, philanthropic organizations, microfinancing, domestic capital markets, PPP in infrastructure, and innovative financing to mobilize additional private capital.	The Acknowledgement of all diversity of private entities (SME, multinationals), philanthropic organizations in the implementation of AAAA.

Source: authors' compilation.

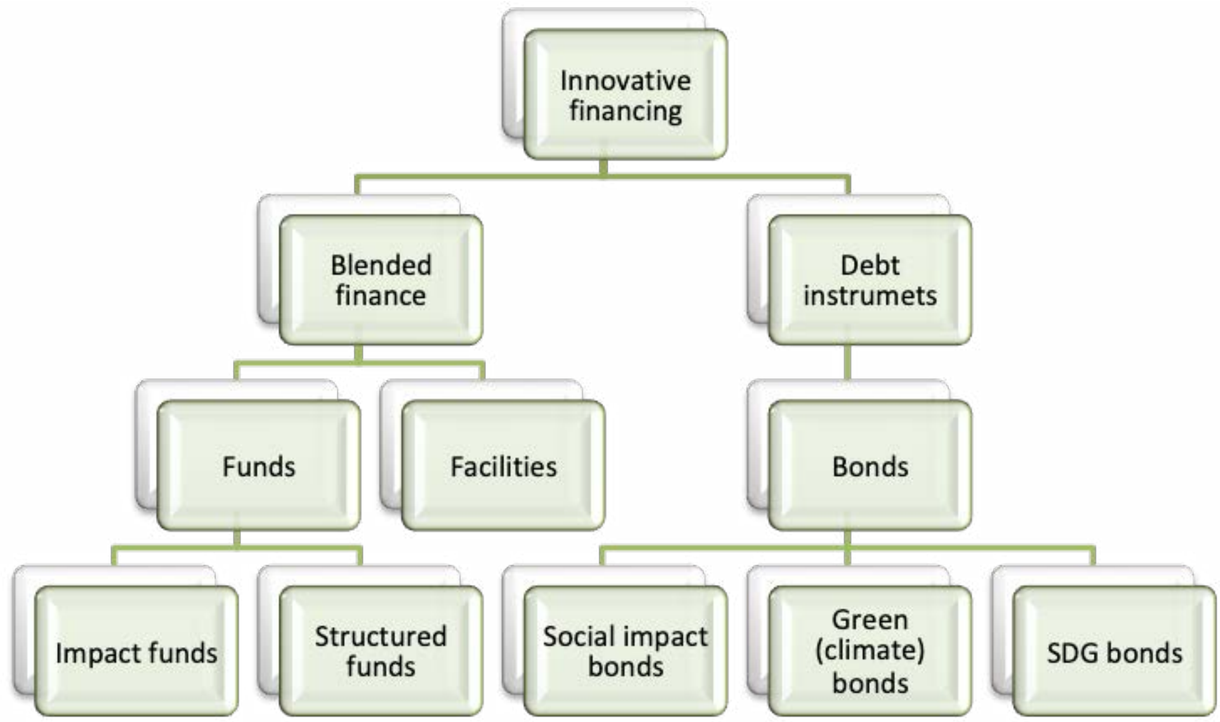
Private sector investments were anticipated to fill the estimated at \$2.5 – \$3.0 trillion annually[28] financing gap needed to achieve the SDGs. Available evidence suggested that transnational corporations, commercial banks, institutional investors possessed trillions of dollars in assets. The value of global assets under management reached \$74.3 trillion in 2018[29]. It was, therefore, reasoned that the international development community had to take on the essential task of channeling normally risk-averse private commercial flows to engaging in investments in developing countries, including in higher risk low income, least developed countries and so-called fragile states.

The AAAA encouraged the use of innovative mechanisms to scale up development flows: "new investment vehicles, such as development-oriented venture capital funds, potentially with public partners, blended finance, risk mitigation instruments, and innovative debt funding structures". According to the AAAA, private sector engagement plays a crucial role in the achievement of the SDGs and the private sector plays an important role as an actor in development cooperation. However, these innovative instruments are in reality not new having been used by donors during the MDGs, but with the formal recognition of blended finance and risk mitigation and debt instruments as innovative, the AAAA launched a new phase of blended financing. Innovative financing thus represents traditional instruments that attract new partners in development finance or new products to attract additional capital for development finance. Among such instruments, most attention is paid to blended finance funds, facilities, and bonds (Figure 3.1) in the realization of the Post-2015 agenda Blended mechanisms combine donor and multilateral concessional finance with commercial investments. Concessional flows in blended financing instruments are seen as warranted to mitigate political, economic, financial, and operational risks, enhance project viability or to help achieve a bigger project development impact. This practice of blending finance had long been in use, for example, by DFIs in their partnerships with commercial banks on development projects in middle and low-income countries.

28 UN (2019). UN Secretary General's Roadmap for Financing the 2030 Agenda for Sustainable Development 2019 – 2021. URL: https://www.un.org/sustainabledevelopment/wp-content/uploads/2019/07/UN-SG-Roadmap-Financing-the-SDGs-July-2019.pdf

29 BCG (2019). Global Asset Management 2019: Will These '20s Roar? . URL: https://www.bcg.com/publications/2019/global-asset-management-will-these-20s-roar

Figure 3.1 - **Innovative financing for development purposes**



Source: author.

Blended finance facilities are risk-mitigating instruments aimed at financing development-related projects that do not meet the requirements of commercial finance. These facilities help mobilize private capital. Most blended finance facilities are managed by DFIs. For example, the IFC's Blended Finance Facility provides senior and subordinated loans, equity instruments, and guarantees to the private sector.

Structured funds are blended finance instrument which mitigates risks and attract private capital for development cooperation. Capital investors can choose to invest in different asset classes according to their risk appetite. Typical asset classes include first-loss tranche (junior) mezzanine and senior tranches. The junior asset class, where donors normally invest, plays the role of a risk buffer. It bears the highest risk and makes the fund attractive to other investors. The mezzanine tranche absorbs losses only after the junior tranche exhausts while the senior tranche enjoys the highest capital protection making it most attractive to private investors by providing the lowest risk and both equity and fixed income[30]. Structured funds are often complemented by technical assistance to mitigate capacity risks. Structured funds invest in infrastructure projects (e.g. Africa50 Infrastructure Fund), microfinance (e.g. Microfinance Initiative for Asia), environment (e.g. Global Climate Partnership Fund), and energy (e.g. Global Energy Efficiency and Renewable Energy Fund).

Impact funds unite official and private asset classes and provide near market-rate returns. Their assets are invested in projects with high social and development outcomes. GIIN's Annual Impact Investor Survey reported $404 billion in impact investing assets under management (AUM) in April 2020[31]. In 2019, impact AUM realized $97,5 billion in profits[32]. In 2020 the biggest recipients of impact funds' capital were the USA and Canada (20%), Latin America and the Caribbean (21%), Sub-Saharan Africa (7%). In 2018, only 55% of funds' managers and owners track the impact performance of their funds for their contribution to the SDGs and 21% reported future plans to launch such tracking[33].

Bonds are a debt instrument suitable for raising funds for projects of developmental importance. Bonds, such as social impact bonds and climate (green) bonds are issued to address specific social or environmental issues and SDG bonds are issued to raise capital for the purpose of SDG-related projects. This market has

---

30 KfW (2016). C. Colia. Mobilisation of private capital. What contribution can development banks make. Perspectives on Development Financing. #4.

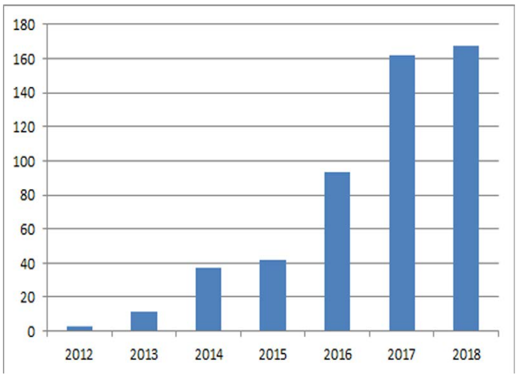
31 GIIN (2020). Annual Impact Investor Survey. URL: https://thegiin.org/research/publication/impinv-survey-2020.

32 GIIN (2020). Annual Impact Investor Survey. URL: https://thegiin.org/research/publication/impinv-survey-2020.

33 GIIN (2018). Annual Impact Investor Survey.

witnessed tremendous growth in recent years with new issuers and countries entering the market each successive year. In 2018, green bonds raised $167.6 billion for projects with environmental benefits[34] (Figure 3.2). In 2018, eight new countries and 204 issuers debuted the global green bonds market[35].

Figure 3.2 - **Green bond issues (euro million)**



Source: Green Bonds

SDG bonds were first issued in March 2017 by the World Bank and raised €163 million. Since 2018, it has issued bonds with a focus on the achievement of specific SDGs (Table 3.2). Unlike traditional bonds, SDG are not fixed-income bonds but are linked to an equity index (Solactive Sustainable Development Goals World Index) that tracks the progress of companies that dedicate at least 20% of their activity to the achievement of the SDGs.

Table 3.2 - **The World Bank SDG bonds**

Date	**Income**	**Maturity**	**Currency**	**Amount**	**Sphere**
March 2017	Linked to equity index (Solactive Sustainable Development Goals World Index)	15-20 years	Euro	€163 million	General
17 January 2018	Fixed rate	5 years	Canadian dollar	CAD 1.5 billion	Empowering women and girls (SDG 5, 10)
10 October 2018	Fixed rate	7 years	SEK	$2,5 billion	SDG 11 (sustainable cities and communities)
12 October 2018	Linked to Solactive Sustainable Development Goals World MV Index	4 years	USD	n/a	Eliminate extreme poverty and boost shared prosperity (SDG 1)

34 Green bonds (2019). Green bonds. The State of the Market 2018.
35 Ibid.

Date	Income	Maturity	Currency	Amount	Sphere
30 August – 21 November 2018	12 bonds	2-43 years	Euro, Mexican peso, Kazakhstani tenge, Indonesian rupiah, Australian dollar, Swedish kron	US$660 million	SDG 14 (life below water) and SDG 6 (clean water and sanitation)
14 December 2018	Solactive Sustainable Development Goals World MV Index	5 years	USD	$3.52 mil-lion	climate, gender, and health issues (SDG 3, 5, 13)
28 December 2018	Fixed-rate, linked to the Solactive Human Capital World MV Index.	5 years	USD	n/a	human capital (SDG 4)
18 January 2019	Fixed rate	3 year	Canadian dollar	CAD 1.5 billion	Health and nutrition of women, children, and adolescents. SDG 3 (ensure healthy lives and promote wellbeing for all at all ages) and SDG 5 (achieve gender equality and empower all women and girls)
8 March 2019	n/a	5 year	Indonesian rupiah	IDR 500 billion	SDGs 1, 2 and 5 (zero poverty, zero hunger, and gender equality, women's empowerment in rural areas)
24 April 2019	Fixed-rate	3 years	USD	$10 million	Challenge of plastic waste pollution in oceans (SDG 14)

Source: various World Bank press-releases.

The main distinguishing elements of private sector engagement in the implementation of Agenda 2030 are the following:

- **Mainstream agenda.** Private sector engagement and blended finance have become a mainstream agenda for development finance in post-2015 assigned a key role in the achievement of the SDGs.

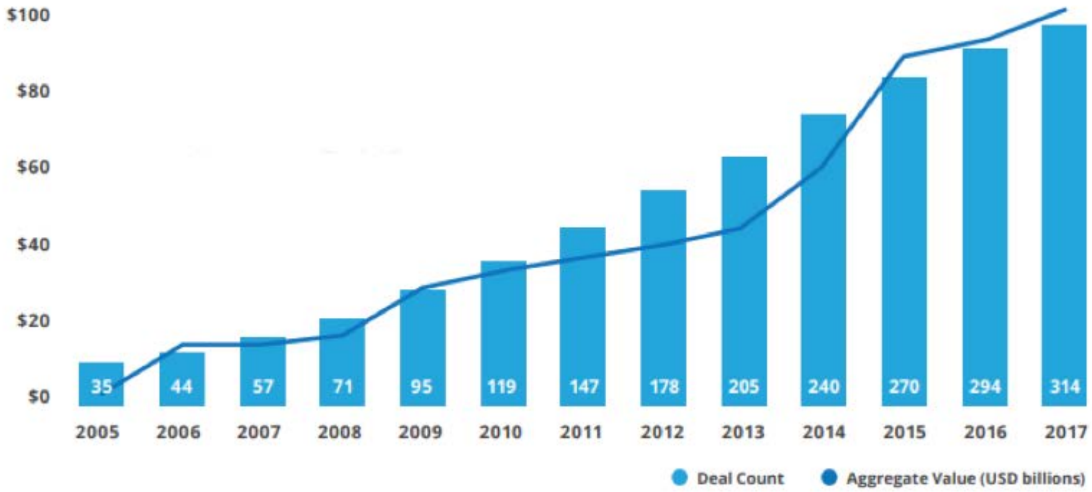
- **Individual initiatives.** Donors have developed unilateral policies and strategies to engage the private sector in the implementation of Agenda 2030. Bilateral and multilateral donors design new instruments or mechanisms to attract private investors as well as develop new tools to position the private sector as a "driver of change" in developing countries.
- **Collective initiatives.** Private sector engagement is accompanied by a series of collective initiatives by the DAC members, multilateral banks, national development institutions, international organizations, and private entities. These initiatives set up financial targets for mobilizing capital and establish an international network of blended finance leaders to push forward private sector engagement as a financing strategy for SDG implementation. Milestones include,
- in 2018, development financial institutions of G7 members launched the "2X Challenge" program to mobilize $3 billion by 2020 jointly
- with private sector businesses managed by women;
- the Global Impact Investing Network (GIIN) of asset owners, asset managers, and service providers established several working groups to promote effective evaluation (GIIN-IRIS working group), the effectiveness of blended finance investments (Blended finance working group), and holding companies (Holdco Working Group), etc.;
- in 2017, the Blended Finance Taskforce, which unites leaders from commercial entities, development organizations and political structures, was founded to address barriers to private sector engagement and increase private investments for the SDGs;
- in 2017, the European Commission adopted its External Investment Plan to allocate mobilized private capital in African countries and European Neighbourhood;
- in 2015, the G20 proposed the Global Partnership for Financial Inclusion (GPFI) in order to develop public-private partnership and promote financial inclusion;
- several initiatives were launched within the UN system; the Forum on Financing for Development (FfD Forum) represents intergovernmental consultations; the SDG Investment Fair is a platform which unites governments, private sector entities and financial institutions to study opportunities for SDG financing;
- in 2015, the World Economic Forum and OECD launched the Sustainable Development Investment Partnership (SDIP) to mobilize $100 billion from philanthropic institutions through blended finance mechanisms for investing in infrastructure. This partnership coordinates and assists private and public entities to scale up blended financing for the SDGs.

The networking and development of partnerships at country and global levels achieved success in the following areas of development finance.

- **Fostering capital markets for sustainable development.** The implementation of Agenda 2030 is characterized by the appearance of capital markets for sustainable development, and the design of new and innovative financing instruments. The experience of SDG bonds shows that it is possible to target private capital engagement for specific sustainable development goals.

- **The increasing volume of private capital engaged.** The number of blended finance deals rose from 35 in 2005 to 314 in 2017 (Figure 3.3). According to the survey by Convergence, the aggregate size of deals amounted to $140 billion in 2018 (in comparison to over $40 billion in 2013). The significant rise in bonds' issuance for development purposes was also reported. However, the noticeable increase in private capital mobilization did not result in the significant rise in private sector ODA reported by the OECD.

Figure 3.3 - **Blended finance deals**



Source: Convergence (2018). The State of Blended Finance 2018.

- **New actors.** For decades, the provider of financial aid and blended mechanism resources was a limited group of donors (DAC members, DFIs, a restricted network of commercial banks and NGOs). New initiatives and blended funds and facilities to de-risk private investments have since emerged, incentivized to enter new markets, expand growth opportunities in pursuit of profitability[36].

4. The role of subsidies in development cooperation

Donors may often use implicit or explicit subsidies to support business interests. Implicit subsidies are by nature more opaque. For example, they can be in the form of interest rate discounts or reduced taxes. Explicit subsidies represent more of a straightforward financial transfer and are intended to compensate returns on equity that are below those a private investor would expect.
Subsides have a controversial role in international development cooperation. On the one hand, they often compensate for the shortage of investments in developing country markets. On the other hand, subsidies contribute to market distortions by undermining competitive forces.
The theory of public economics outlines the pros and cons of subsidising private investment. First, is the ability to address the problem of insufficient financial returns or excessive risks in developing country markets. Second, subsidies contribute to an increased rate of capital accumulation (both physical and human capital). Third, subsidies help overcome market failures associated with instances when free markets fail to allocate goods and services at socially optimal levels[37].

Disadvantages are associated primarily with market distortions. First, they can give rise to mismatched demand and supply that the cost-effectiveness of the project is questioned. Hence, subsidized projects should be commercially viable.

Second, the idea of "turning billions into trillions"[38] is not always applicable for developing countries. The main reasons concern the lack of incentives (poor investment climate factors) for doing business and the macroeconomic consequences of external aid primarily associated with inflation. Hence, subsidies for private investment should be determined by the supply of investments.

Given these drawbacks and because of negative public perceptions, donors rarely use the term "subsidy", preferring instead terms such as 'blended finance' and 'smart levers'[39,40].

---

36 WEF, OECD (2016). Insights from Blended Finance Investment Vehicles & Facilities

37 Miller, H. (2013) 'What practical approaches/frameworks are there for effectively delivering subsidy to private sector entities for development purposes?'. Economic And Private Sector, Professional Evidence And Applied Knowledge Services [EPS-PEAKS].

38 This idea primarily deals with the 'blended finance' or the idea of using a small amount of aid to 'leverage' large amounts of private finance to achieve the SDGs. 'From billions to trillions: transforming development finance. Post-2015 financing for development' published by The Development Committee of the World Bank and IMF

39 The IFC Blended Finance Unit. URL: https://www.ifc.org/wps/wcm/connect/02ad63804d920789b2dab748b49f4568/Blended+Finance+at+IFC.pdf?MOD=AJPERES

40 OECD (2014) Development Co-operation Report 2014: Mobilising Resources for Sustainable Development.

International experience shows that some countries are using subsidies as a legitimized tool for private sector involvement in development. The EU provides support through grants or subsidized business development services[41]. Moreover, the European Investment Bank (EIB) has an official mandate to use subsidized interest rates when projects meet certain environmental or/social impact requirements[42].

From the DAC perspective, subsidies used in international development cooperation are classified as ODA, since they support activities with a commercial objective. However, in some cases, official interest subsidies may be reported as grants by donors and hence classified as ODA. This happens if the potential development effect of the subsidy has been verified by the governments[43].

Donors justify private sector subsidies as being a necessary means to overcome the investment gap in developing countries and thus contributing to public benefits, such as new knowledge generation, human capital development, etc. In practice, the rules on private sector engagement are not well defined. They also depend on how the principle of financial and developmental additionality is applied by donors; which approach is not harmonized across all donors. The lack of clarity on the guiding principles of subsidies use presents risks, both for donors and beneficiary countries because blending could finance private investments under development cooperation with questionable development impact or relevance,[44] or benefit private companies while reducing returns for donors. For example, in practice, most private companies from donor countries receive subsidies for their activities in LDCs as compensation for the perceived risks of operating in fragile markets but this practice could result in an oversupply of investments investors' in the face of a lack of viable investment projects and the crowding out of local investors in LDCs. Moreover, donors often do not have the necessary evidence base on the developmental impact of previous and prospective projects and the effectiveness of blending mechanisms. This leads to a lack of selection criteria and enforcement of adequate safeguards[45].

Restrictions on subsidies use

International frameworks provide a set of rules on the use of subsidies. The WTO provisions are the most universal and impactful. The WTO Agreement on Subsidies and Countervailing Measures (ASCM), contains restricts the use of subsidies and countervailing measures., It provides a definition of subsidies and classifies them according to their impact on the terms of trade, and establishes rules for conducting compensation investigations and the use of compensatory measures. In particular, the WTO prohibits subsidies contingent on the use of domestic goods (local content) or export performance.

The provisions of the ASCM are applicable without any exceptions or reservations to all WTO members, except in the case of developing countries eligible for "special and differential treatment". Accordingly, developing countries enjoy certain benefits, including the possibility to apply subsidies as a legitimate tool in agriculture, such as investment and agricultural input subsidies to benefit low-income or resource-poor producers.

However, the main challenge for the stakeholders remains establishing proof that subsidies have a positive effect on socio-economic development and the level of investment in developing countries. The evidence base is often lacking and rigorous evaluations are not systematically undertaken. This can partly be attributed to the fact that many social benefits of subsidized investments emerge slowly and are hard to trace. That is why the rigorous evaluation of results is of great importance given the opportunity costs of financing particular projects. To avoid the misuse of official resources, donors should define in detail the project conditions under which blending becomes developmentally justifiable and how development impact is ascertained. A balance should also be established between the "subsidized" expansion of private business, its developmental additionality, and the interests of beneficiary countries in the achievement of the SDGs[46]. The DAC members have yet to harmonize the principles of evaluation practice. So far, only multilateral development banks have made progress on coordinated principles for unlocking private sector capital and the evaluation of the effectiveness of their mobilization efforts.

---

41 The Future Role of the Private Sector in Development Cooperation: an overview of key policy processes. CONCORD. Swedish and European CSOs for global development. June 2014

42 EIB (2014) Annual Report on EIB activity in Africa, the Caribbean and Pacific, and the overseas territories.

43 Is it ODA? Factsheet – November 2008. OECD. www.oecd.org/investment/stats/34086975.pdf

44 Carter P. (2015) Why Subsidise the Private Sector? What donors are trying to achieve, and what success looks like? ODI Report.

45 Carter P. (2015) Why Subsidise the Private Sector? What donors are trying to achieve, and what success looks like? ODI Report. P. 48.

46 OECD (2018). Measuring the results of private sector engagement through development co-operation.

5. Monitoring and evaluation of private sector instruments

The 2014 DAC High-level meeting adopted a decision to modernize its statistical framework in order to monitor and measure members' deployment of a wider range of instruments and engagement of a variety of economic agents as part of their intended contribution to the achievement of the sustainable development goals. The modernization aimed to capture the more sophisticated financial instruments used by DAC members, provide reliable figures on development finance mobilized, and to ensure comparability of data across providers and instruments, including in terms of avoiding double-counting and to the artificial inflation of the volume of ODA. The new methodology was intended to ensure accountability and harmonization of different statistical standards of bilateral and multilateral donors thus providing transparency and garnering the attention of the business sector and other economic agents. The objective was also to enable the DAC to analyze the efficiency and impact of development finance interventions.

One of the main disadvantages of members associated with the predecessor statistical system was the way grants and loans were accounted for. Grants were provided for on a "gift" basis, however, the grant element in loans was not similarly captured. Loans were accounted for at face value, thus donors were concerned that the system did not properly reflect the extent of their effort Thus, a major objective of the modernization of the accounting system is improving the statistical measurement of grant elements across all instruments.

The grant equivalent system was officially introduced in 2019 and the OECD issued preliminary ODA statistical data applying the new methodology. To ensure comparability with data issued in the past, the OECD continues to provide data based on the previous standard. Other improvements to the statistical system include the application of discount rates to loans granted under different terms.

Other areas where changes have been made include in the measurement of ODA are peace and security expenditures, private sector instruments, and refugee costs. For example, for to refugee costs DAC members have applied different standards to reporting refugee costs in response to increased budget pressure felt since the 2010s in the wake of the refugee crisis in Europe. Some countries reported the costs from the time of application for asylum, while others reported from the time the decision is issued on the asylum applications with some DAC members excluding expenditures when asylum applications were rejected[47]. Different approaches were also applied on which of a variety of expenditures (accommodation, medical care, food, administrative costs, etc.) were reported as ODA and on whether refugee expenditures were at all included. A decision by DAC members in 2017 clarified the principle for the reporting of refugee costs; henceforth, refugee costs are classified as a form of humanitarian assistance with a limit of 12 months costs and the requirement for the date of application for asylum and its decision to be included for purposes of classification as ODA.

Besides, according to the OECD, significant progress has been made in the elaboration of principles for the monitoring and evaluation of private capital instruments. However, the OECD report on blended finance states that the situation with regards to the monitoring and evaluation of private sector instruments is "less developed than for other development co-operation activities"[48] .

Several accountability challenges are associated with the monitoring and evaluation of private sector operations. Firstly, the necessity to distinguish commercial private flows from private engagement is an important issue[49]. The OECD statistical monitoring of private sector flows mobilized by official sources assumes additionality of private capital, e.g. without official development finance private capital wouldn't participate in the financing of development projects. This principle of additionality derives from the approach used, for example, by multilateral development banks and is assessed as "beyond what is available in the market" and which "should not crowd out the private sector"[50]. However, as already mentioned and as so far applied, the concept lacks a strong evidence base. The relationship between official interventions and the attraction of private sector capital and the extent, to which private capital is mobilized, is not an obvious one.

---

47 OECD (2019). In-donor refugee costs reported as ODA by OECD-DAC members URL: http://www.oecd.org/dac/financing-sustainable-development/In-donor-refugee-costs-in-ODA.pdf

48 OECD (2018). Making Blended Finance Work for the Sustainable Development Goals.

49 OECD (2016). High Level Meeting. Communique. February, 19.

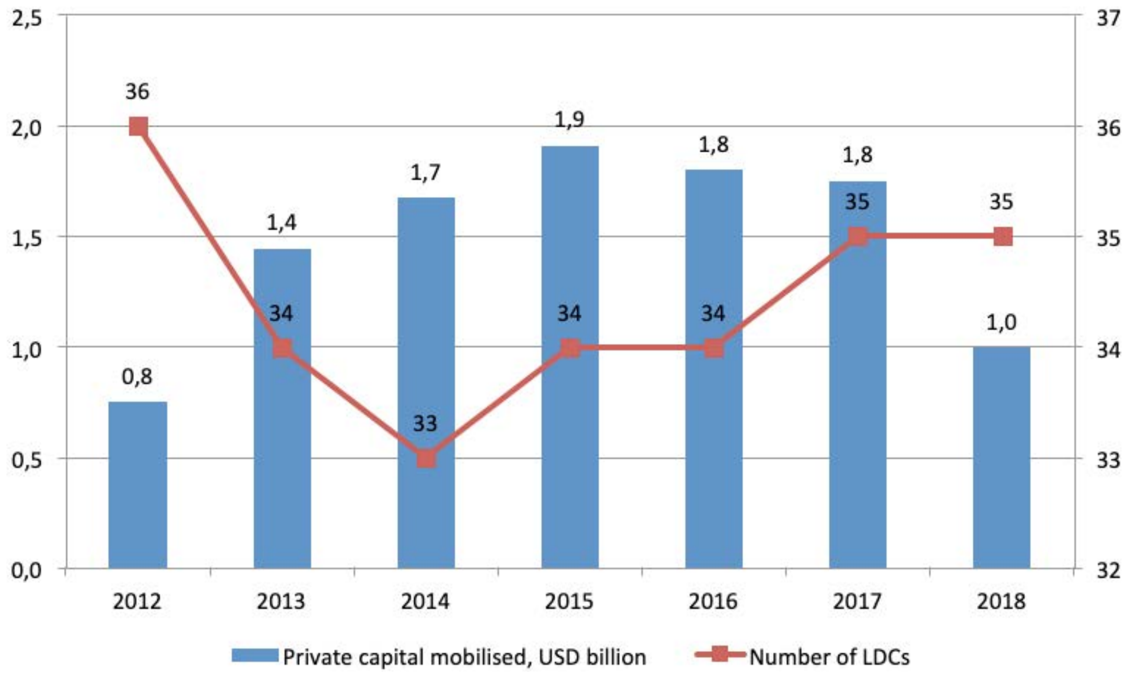
50 Multilateral Development Banks' Harmonized Framework for Additionality in Private Sector Operations. (2018).

6. Private sector engagement in LDCs in 2012-2018: statistical overview

According to OECD data[51] the total amount of capital mobilized from the private sector and channelled to LDC reached $10.34 billion in 2012-2018[52]. The LDCs' share (excluding regional allocations) accounted for 6,3% of the total capital mobilized from private sources and 6.9% of private capital distributed to individual countries.

For the least developed countries, mobilized private capital remains insignificant and accounts for about 5,8% of the total volume of ODA disbursed. This shows that LDCs rely mainly on official development finance although some research shows that commercial private capital flows are positively associated with official development finance commitments[53].

Figure 6.1 - **Private capital mobilized in LDCs in 2012-2018**



Source: Author calculations based on OECD data .

The distribution of mobilized private capital flows in LDCs is uneven. The top 3 country destinations received nearly 30% of all mobilized private finance and the top 10 countries accounted for the remainder. The top beneficiary LDC in 2012-2018 was Angola ($1.1 billion) followed by Bangladesh ($1.0 billion) and Myanmar ($1.0 billion). According to the OECD statistical survey, Angola's receipts comprise several guarantees granted by the World Bank Group a small number of large projects that enabled the inflow of more than $800 million in additional private investments. In contrast, investments in Bangladesh and Myanmar were characterized by a large number of smaller sized operations.

Private capital participation was registered in 43 out of 47 LDCs. Four LDCs did not benefit from any mobilized private capital (Comoros, Eritrea, Kiribati, and Tuvalu). The previous survey on blended finance (2012-2015) recorded an absence of such operations in 13 countries out of 48 LDCs[54]. The increase in the number of countries is attributable to the enhanced private capital engagement operations and the increased coverage of statistical monitoring by the OECD.

Despite the increase in the total number of countries

---

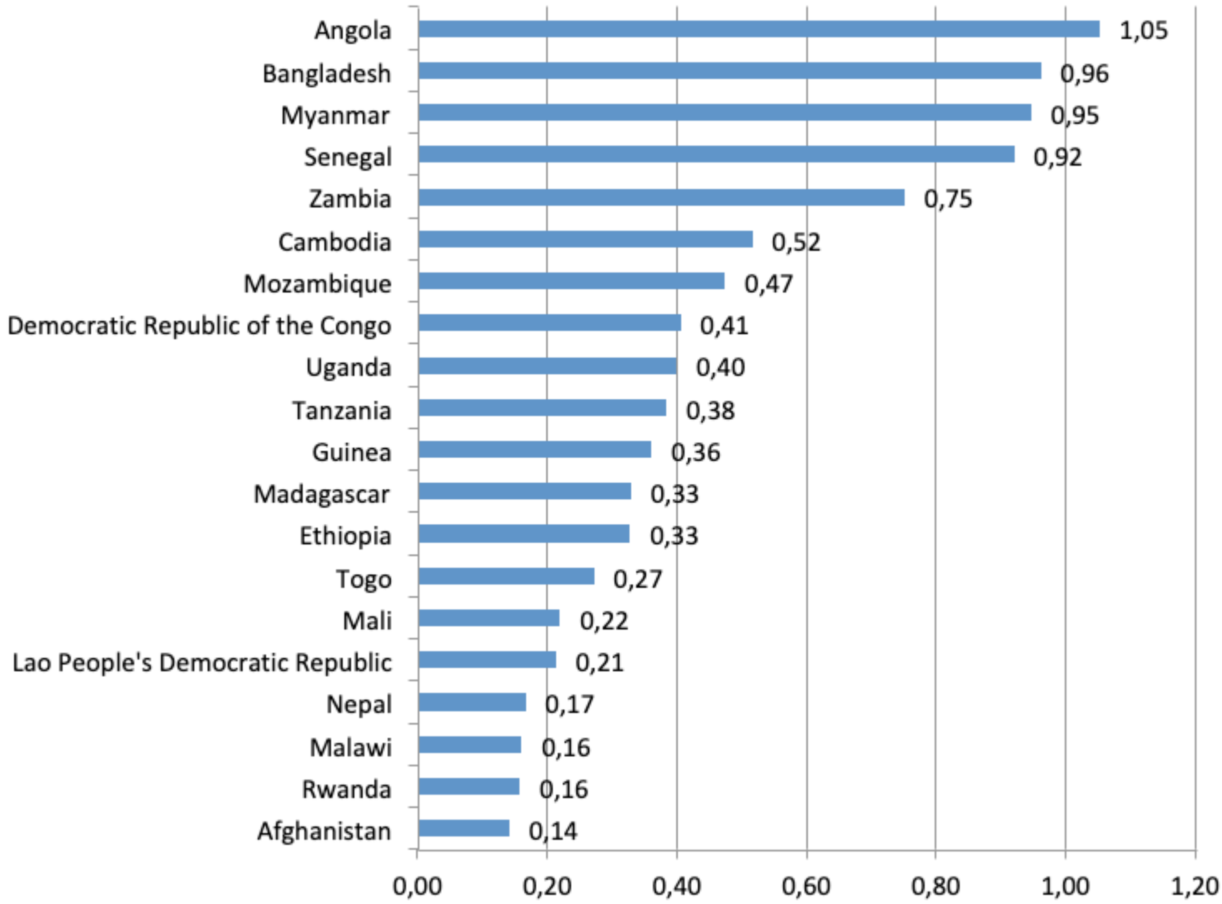
51 OECD data on private sector engagement are estimates valid for 2020, August 20. The data on multilateral organizations are not available for 2018 due to confidentiality issues. For 2018, the data presented covers additional private capital raised by bilateral donors only. The statistical data for 2016-2017 are valid for 2019, 10 April (2017 data for Japan were added later).

52 OECD (2019). Amounts Mobilized from the Private Sector by Development Finance Interventions in 2012-17. Preliminary insights from the data.

53 Dasgupta D., Dilip R. (2000). "What factors appear to drive private capital flows to developing countries? And how does official lending respond?", World Bank Policy Research Working Paper, no 2392.

54 UNCDF (2018). Blended finance in the Least Developed Countries.

Figure 6.2 - **Distribution of mobilized private capital among top 20 beneficiary countries in 2012-2018 ($ billion)**



Source: Author calculations based on OECD data.

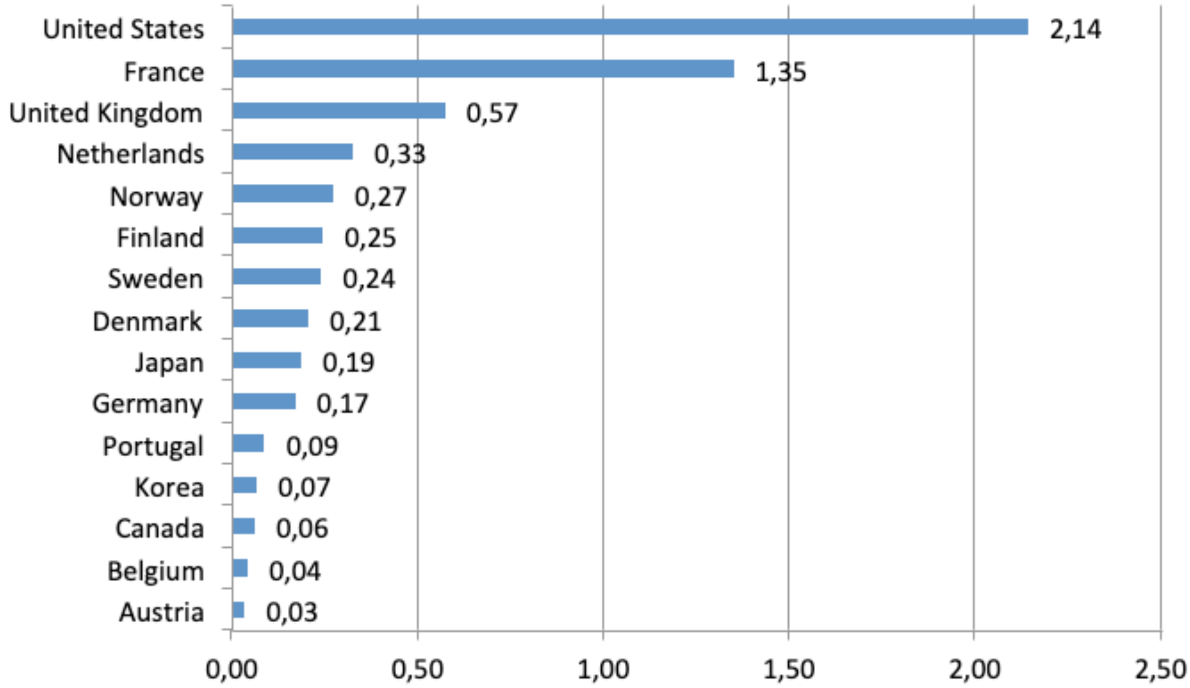
involved in mobilized private sector investments only 26 LDCs regularly unlocked additional private finance in 2012-2018. In total, 36 countries engaged additional private capital inflows. Year on year, between 25-30% of LDCs attract no additional private capital and such inflows are erratic for nearly half of the LDCs. The data suggests that many LDCs, an especially small island and landlocked countries, face difficulties in attracting private capital.

Globally, Sub-Saharan Africa, which comprises most LDCs, engaged 69.4% ($7.2 billion) of all mobilized private capital in 2012-2018. Private capital amounting to $2,3 billion (22,2%) reached South and Central Asia while Far East Asia unlocked $0,8 billion (7,3%) of blended finance. Collectively, the share of Middle East Asia, North and Central America and Oceania amounted to more than 1%.
According to the most recently available data, multilateral organizations provided a bigger share of mobilized private capital to LDCs, accounting for 52.2% in 2012-2017. Guarantees, provided by multilateral organizations are the most requested instrument in LDCs. The Multilateral Investment Guarantee Agency (MIGA), which accounts for 30% of mobilized private capital investments in LDCs, unlocked $2.8 billion of additional private capital through providing guarantees for private investors. The International Finance Corporation and the Private Infrastructure Development Group are second and third largest multilateral sources of mobilized private capital at $0.5 and $0.4 billion respectively.

Bilateral donors unlocked 46.9%[55] of mobilized private investments in 2012-2017 (see Figure 6.3). In 2012-2018, the main contributors were the United States (2.1 billion) and France ($1.4 billion).
In 2012-2017, 28.5% of mobilized private capital

55 The sum of bilateral and multilateral sources of mobilized private capital account for 99.2%. The rest represents multidonor fund or facility.

Figure 6.3 - **The distribution of mobilized private capital among bilateral donors in 2012-2018 ($ billion)**



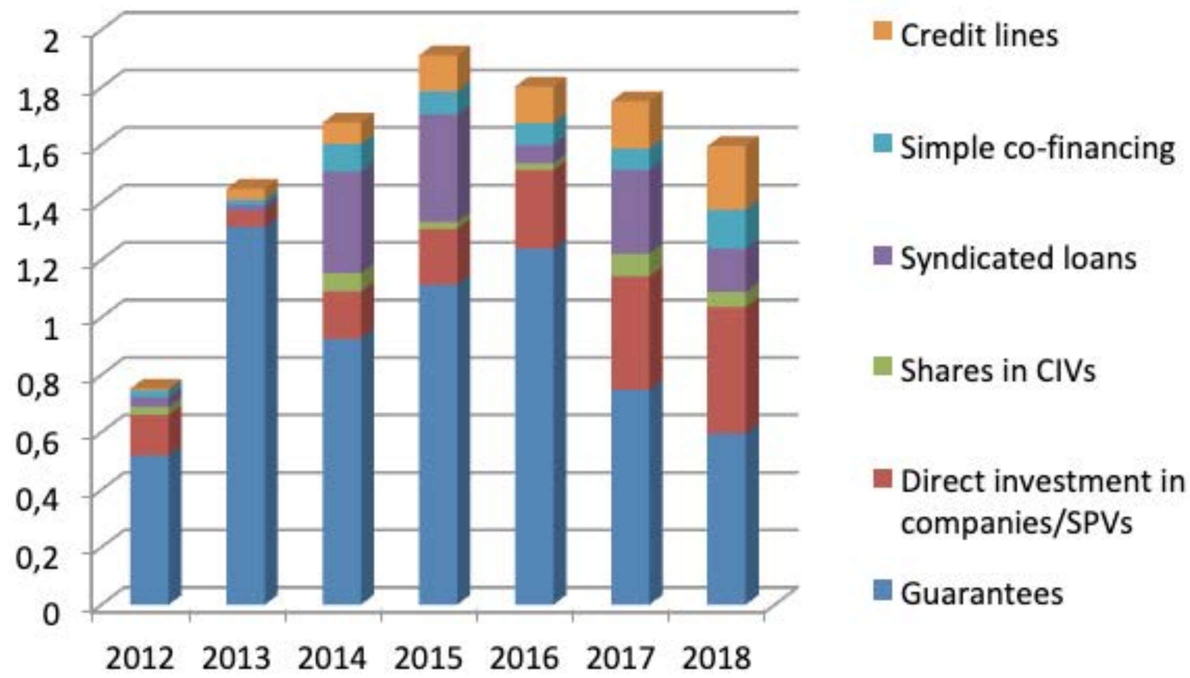
Source: Author calculations based on OECD data.

originated from OECD or other high-income countries. The high share (23.3%) of this group of countries is explained by the high average number of operations by OECD domestic private investors in all mobilized private capital accounting for 400 projects–most funded via simple co-financing. Provider country private investors explain 16% of private sector operations.

According to preliminary data provided by the OECD, guarantees were the leverage mechanism that allowed to mobilize $ 6.5 billion of private capital to LDCs in 2012-2018 (see Figure 6.4 and 6.5). The share of guarantees not accompanied by official flows among all instruments reached 59% during 2012-2018.

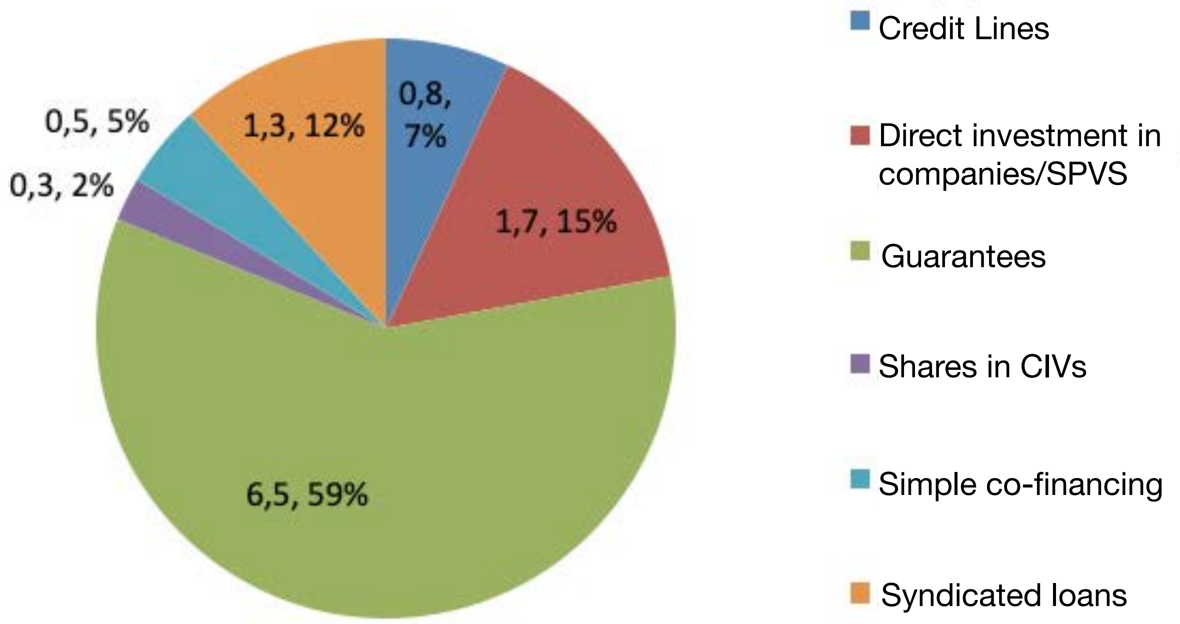
The sectoral distribution of mobilized private capital in LDCs shows a concentration of private business operations in

Figure 6.4 - **Distribution of mobilized private capital in LDCs by instrument ($ billion)**



Source: Author calculations based on OECD data

Figure 6.5 - **Share of selected private sector instruments in LDCs in 2012-2018 ($ billion and %)**

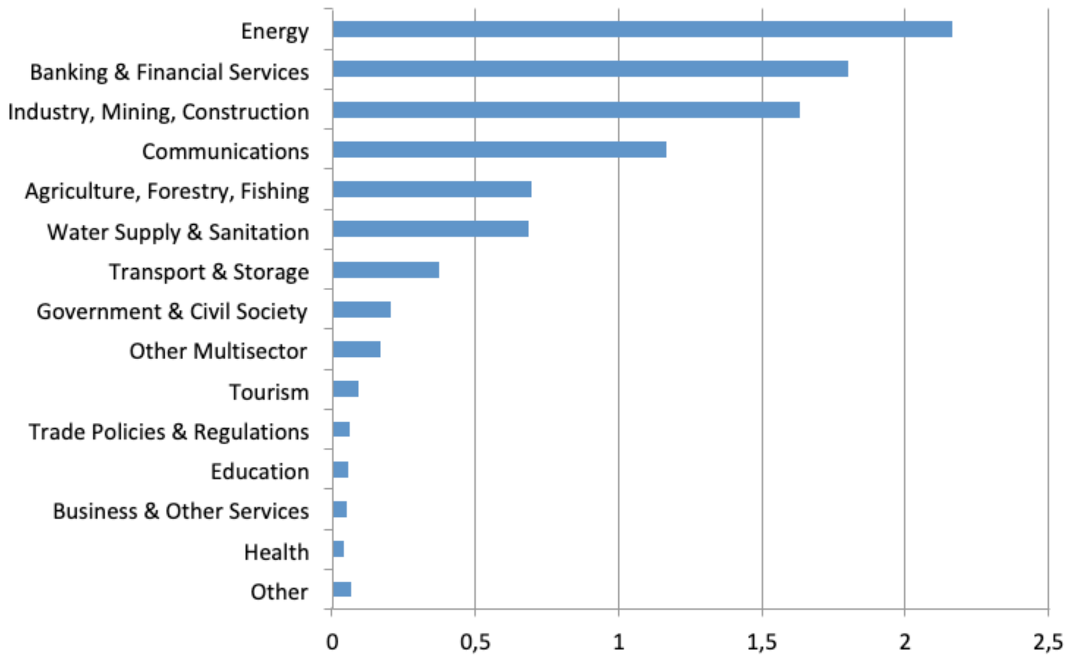


Source: Author calculations based on OECD data

revenue-generating sectors[56] (see Figure 6.6). Energy, banking and financial services and industry, mining, construction collectively attracted $5.6 billion (60.4%).

More detailed analyses of the purpose of engaged private sector investments show that the biggest share went to formal sector financial intermediaries

Figure 6.6 - **Sectoral distribution of engaged private capital in LDCs in 2012-2018 ($billion)**



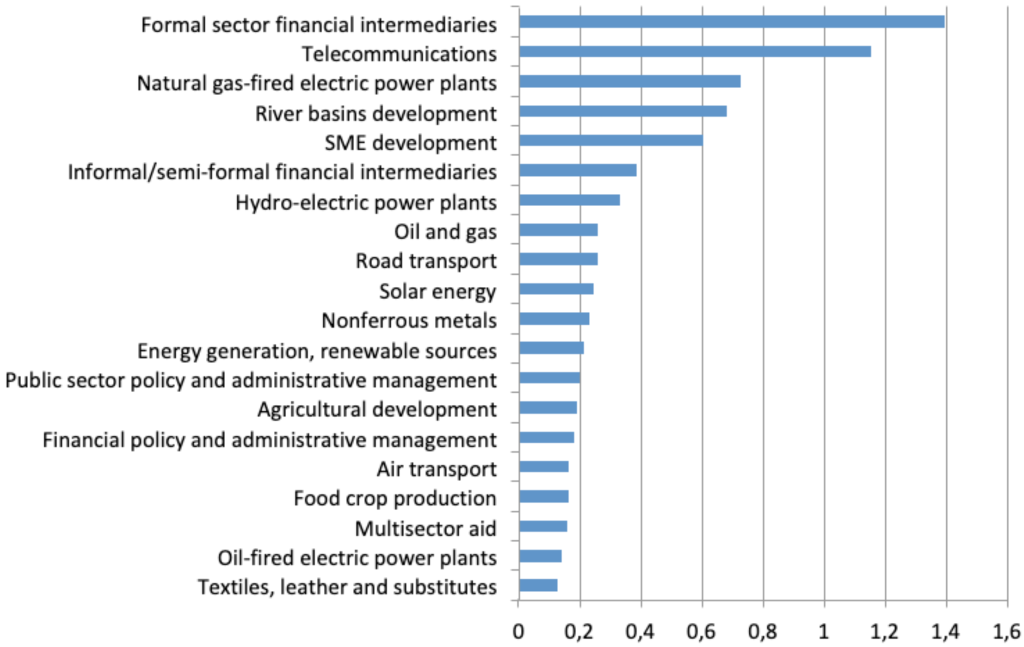
Source: Author calculations based on OECD data.

56 UNCDF (2018). Blended finance in the Least Developed Countries.

(see Figure 6.7).

The analysis shows that the volume of mobilized private sector flows is associated with the size of the recipient economy. This association is statistically

Figure 6.7 - **Purpose of allocations of the engaged private sector in LDCs in 2012-2018 ($ billion)**

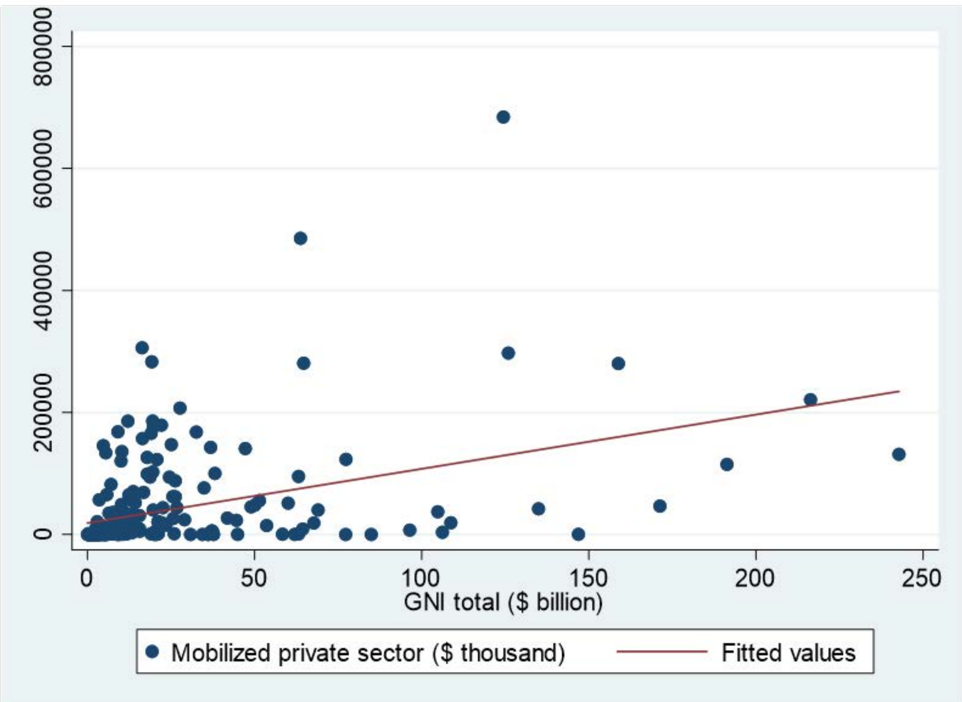


Source: Author calculations based on OECD data.

significant (Figure 6.8). It confirms the hypothesis that bigger economies are likely to attract/absorb more investments.

7. The challenges and gaps of the post-2015 development cooperation framework on private development finance

Figure 6.8 - **Distribution of mobilized private capital in LDCs according to GNI in 2012-2017**



Source: Author calculations based on OECD data.

7.1 Collective and individual initiatives

The idea of private engagement in development cooperation has been discussed since the beginning of the 2000s, with the Monterrey Consensus (2002) on financing for development having become one of the first official documents in this field. The private sector has also become an integral topic in the discussion on international aid effectiveness/effective development co-operation. Its role was reflected in documents such as the Paris Declaration, Accra Agenda for Action, Busan Partnership Agreement, Mexico Communiqué, Nairobi Outcome Document, as well as Addis Ababa Action Agenda (Table 7.1). Cooperation with the private sector has become considered as a mechanism contributing to enhanced aid effectiveness. Countries have declared engagement with the private sector as one of their priorities in international development cooperation.

Monterrey Consensus

Table 7.1 - **Evolution of the aid effectiveness agenda and the role of the private sector**

Monterrey Consensus (2002)	Paris Declaration on aid effectiveness (2005)	Accra Action Agenda (2008)	Busan Partnership Agreement(2011)	Mexico Communiqué [1st High-Level Meeting of the GPEDC] (2014)	Addis Ababa Action Agenda (2015)	Nairobi Outcome Document [2nd High-Level Meeting of the GPEDC] (2016)	A Senior-Level Meeting (2030 Agenda and the SDGs) (2019)	19th Steering Committee Meeting of the Global Partnership (2020)

Source: author compilation based on GPEDC.

The Monterrey Consensus[57] stipulates engagement with the private sector as one of the priority areas of international development cooperation. Specifically, the Consensus calls for the mobilization of international resources for development through foreign direct investment (FDI) and other private resources. FDI and other private capital resources are considered vital complements to national and international development efforts. FDI is associated with economic development through its potential contributions to knowledge and technology transfer, job creation, increased overall productivity, and competitiveness. Moreover, FDI is associated with potential of promoting business development at micro-level and helping to eradicate poverty through economic growth (paragraph 20 of the Monterrey Consensus). The Consensus places emphasis on the need for measures to improve investment climate factors, such as fighting corruption, entrepreneurship support, good governance, appropriate institutions, and infrastructure development, to attract private capital.

The Consensus is one of the very first attempts by the international community to raise the effectiveness of international development cooperation[58] in partnership with the private sector. The relevance of the Monterrey Consensus was strengthened in 2018 by the DAC OECD's incorporation of private capital as a type of ODA flow[59].

High-Level Meetings of the GPEDC

The first High-Level Meeting of the Global Partnership for Effective Development Cooperation took place in 2014[60] is another important milestone. The Mexico Communique signed as a result of the meeting reiterated the role of business as equal partners in development. First, it emphasized the indirect influence of the private sector on poverty eradication through knowledge sharing and technology transfer, job creation, as well as expanded access to goods and services. Second, the role of public-private partnerships (PPPs) was underlined as a mechanism to align business and core development objectives through enhancing the delivery of shared value and the reduction of business risks. Third, the role of SMEs was also recognized in enhancing the development impact. The reiteration of these priority areas has contributed to the expansion of the international agenda on private sector development engagement albeit much

57 The Monterrey Consensus on financing for development. URL: https://www.un.org/en/development/desa/population/migration/generalassembly/docs/globalcompact/A_CONF.198_11.pdf

58 A term introduced in 2011 by the Busan Declaration.

59 OECD (2020). Official development assistance – definition and coverage. URL: https://www.oecd.org/dac/stats/officialdevelopmentassistancedefinitionandcoverage.htm

60 First High-Level Meeting on Global Partnership for Effective Development Cooperation. URL: http://effectivecooperation.org/events/1st-high-level-meeting/

of the responsibility was placed on governments to address regulatory impediments to enhanced business participation in international development cooperation.

The Second High-Level Meeting took place in Nairobi in 2016, where a special focus was placed on the SDGs. The debate on effective development cooperation was the subject of a Senior-Level Meeting in New York in 2019. The meeting reaffirmed the crucial role of effective cooperation in the pursuit of the 2030 Agenda and the SDGs[61]. The 19-th Steering Committee Meeting of the Global Partnership was held on 11-12 May 2020 in an online form.

Addis Ababa Action Agenda

The Addis Ababa Action Agenda reiterates the vital role of the private sector in achieving development goals. It recognizes the potential of all enterprises, ranging from the smallest micro-enterprises to the largest multinationals in solving development challenges.

First, the agenda underlined the progress achieved since the Monterrey Consensus in such fields as investment climate and private sector growth. According to the Agenda, progress on investment climate factors was registered with respect to contract enforcement and property rights.

Second, the Agenda raises the problem of the short-term orientation of FDI in developing countries, which is attributable particularly to the lack of compliance with international labour rights and environmental and health standards (such as the Convention on the Rights of the Child, Global Compact and other key multilateral environmental agreements).

Third, affordable financial services were acknowledged as one of the most important sources of poverty eradication and sustainable development. An inappropriate regulatory environment and risk-mitigating measures were indicated as a barrier to financial inclusion of the most vulnerable business and social stakeholders (such as SMEs and women, respectively).

Special focus is also given to the alignment of private sector incentives with public goals, such as sustainable development and long-term quality investment. To achieve this purpose, the Agenda calls for appropriate regulatory frameworks and conducive environments.

Thus, the AAAA has reiterated and deepened the topic of private sector engagement as a precondition for more effective and efficient aid delivery.

Private and public frameworks

There is a wide range of public and private initiatives launched at national, regional, and international levels. The frameworks have different goals depending on their objectives and stakeholders. Table 7.2 summarizes the main frameworks.

Table 7.2 - **The main public and private initiatives in the field of mobilization of private finance for development**

Name of the initiative	Main goal
2X Challenge	Mobilizing $3 billion by 2020 from DFIs and private sector businesses managed by women
Global Impact Investing Network (GIIN)	Effective evaluation practices promotion
Blended Finance Taskforce	Defining barriers to private sector engagement and increase private investments for the SDGs
G20 Global Partnership for Financial Inclusion (GPFI)	Public-private partnership development
Forum on Financing for Development (FfD Forum)	Exploring opportunities for SDGs' financing
External Investment Plan (EIP)	Mobilizing capital in African countries and European Neighbourhood
Sustainable Development Investment Partnership (SDIP)	Scaling up blending financing to finance the SDGs
Tri Hita Karana (THK) Forum for Sustainable Development	Mobilizing private capital and innovation for the SDGs in Indonesia and South East Asia

Source: compiled by authors.

[61] 2019 Senior-Level Meeting. URL: http://effectivecooperation.org/

Public initiatives

Most of the public frameworks are associated with the international, regional, and national levels. The G20 Global Partnership for Financial Inclusion (GPFI)[62] is a global framework that fosters coherence across international private and public sector initiatives, such as the Alliance for Financial Inclusion (AFI), the Consultative Group to Assist the Poor (CGAP), the International Finance Corporation (IFC), OECD, the Better than Cash Alliance and the International Fund for Agricultural Development (IFAD), etc. The Partnership contributes to peer learning, knowledge sharing, policy advocacy and coordination, including putting into practice the G20 Principles for Innovative Financial Inclusion[63]. The global frameworks are associated with other topic-specific initiatives, such as the 2X Challenge and the ECOSOC Forum on Financing for Development and Sustainable Development Investment Partnership (SDIP)[64] etc.

An example of a regional framework is the External Investment Plan (EIP)[65], adopted by the European Commission in 2017. It is focused primarily on promoting private investments in African and EU neighborhood countries. It aims to promote socio-economic development and address a number of risks and barriers to private investment. The THK Forum for Sustainable Development is a public regional framework, which focuses on networking activities[66].

USAID's policy on private sector engagement (PSE) is an example of a private sector engagement framework at the national level[67]. It aims at reducing transaction costs of business and risks reduction for work at the markets of developing countries.

Most of the public frameworks at the national and regional level are driven by sovereign donors and are correlated with their economic and political interests in respective developing countries. First, these frameworks are heavily associated with interventions that help donor own-country business to penetrate the markets of recipient countries. For example, the EU EIP focuses on providing technical assistance for the preparation of private sector investment projects in LDCs, where the costs of setting up and doing business are three times higher than in other developing countries[68].

Second, the frameworks are associated with the creation of favourable investment and business climate conditions, such as risk mitigation, support for domestic economic reforms, and economic governance in developing countries contributing to boosting further the engagement and participation of the private sector. This component is realized through bilateral inter-governmental cooperation.

Third, some of the frameworks have a non-financial network effect, which often stimulates businesses from different countries (both donor and recipient) to cooperate.

Fourth, the efficiency of the frameworks is associated mostly with a financial effect rather than a developmental impact. The financial effect is expressed as the amount engaged private sector capital as a proportion of the total resources allocated by the public frameworks. Guarantees to banks lending to the entrepreneurs and technical assistance are among the key mechanisms used by the frameworks. Guarantees do not imply the financial involvement of official donors. The success of most of the projects supported can be often evaluated as the moment when private resources have been mobilized. Some of the frameworks have been in operation long enough to demonstrate positive results according to these criteria. For instance, the EFSE[69], supported by the EU EIP, realized investments of about $271 million in 2017 using $5.1 million EU public finance[70].

Private initiatives

In addition to a wide range of global initiatives discussed

---

62 GPFI (2019). The G20 Global Partnership for Financial Inclusion.

63 G20 Principles for Innovative Financial Inclusion (2010). URL: https://www.gpfi.org/sites/gpfi/files/documents/Principles%20and%20Report%20on%20Innovative%20Financial%20Inclusion_0.pdf

64 SDIP (2019). Sustainable Development Investment Partnership. URL: http://sdiponline.org/

65 EU External Investment Plan (2017). URL: https://ec.europa.eu/commission/eu-external-investment-plan/what-eus-external-investment-plan_en

66 THK Forum for Sustainable Development (2018). URL: http://www.thkforum.org/

67 PSE (2019). USAID policy on private sector engagement. URL: https://www.usaid.gov/work-usaid/private-sector-engagement

68 EU External Investment Plan (2019). Factsheet. URL: https://ec.europa.eu/commission/sites/beta-political/files/external-investment-plan-factsheet_en.pdf

69 Neighbourhood window of the European Fund for South East Europe (2018). URL: https://ec.europa.eu/commission/sites/beta-political/files/external-investment-plan-examples-eastern_en.pdf

70 Examples of eligible operations – Eastern Partnership countries (2018). URL: https://ec.europa.eu/commission/sites/beta-political/files/external-investment-plan-examples-eastern_en.pdf

71 GIIN (2019). Global Impact Investing Network's. URL: https://thegiin.org

72 Blended Finance Taskforce (2019). URL: https://www.blendedfinance.earth/about

above, there exists a set of private frameworks. Examples of such initiatives are the Global Impact Investing Network (GIIN)[71], Blended Finance Taskforce (BFT)[72], and others also discussed in this chapter. Most are established as international NGOs.

In line with most public frameworks, private frameworks are aimed at attracting private capital while reducing investment risks. The approach is usually associated with the impact investment stimulation. Some of them are topic-related, such as aiming to promote education or research activities to accelerate the development of the impact investing businesses. For instance, the US NGO, GIIN, is focused on helping private investors to address the challenges associated with impact investments, such as the lack of transparency, market data, partnerships, and expertise. The framework is promoting industry networks and events in the US and in the rest of the world. It provides a wide range of tools associated with research, educational resources, community of practice and analytics (IRIS and IMM)[73].

The BFT was initiated as a task force to contribute to effective use of blended finance by the Business & Sustainable Development Commission in 2017. It is more focused on mainstreaming private engagement for the achievement of the SDGs. It is intended to cooperate with the MDBs, asset owners, and the national governments.

However, the frameworks lack relevant tools to tackle several common problems with respect to development finance. First, most of the private initiatives and businesses themselves have a shortage of motivation and capacities to implement impact evaluations to gather lessons from their past investments. Such kind of assessments would make it easier to identify relevant sector- and country-specific instruments.

Second, most of the mechanisms (such as green bonds) currently used by businesses in industrial countries are not used in LDCs. This substantially limits the number of available investment mechanisms for the poorest nations. Moreover, most of the private frameworks are focused primarily on emerging markets and miss the LDCs.

Third, the private frameworks are not consistent with each other with a shortage of coordination among the stakeholders. In order to get more value from practical approaches to development finance it would be desirable to establish a coordination mechanism among the private frameworks and to make them more consistent with the public initiatives.

The AAAA accentuated the importance of private capital mobilization and innovative financing for development purposes. It gives a general approach on private capital engagement without paying attention to the individual characteristics of LDCs in the development agenda. Highly risky environments of LDCs require a special approach to the attraction of private investors. Statistical data provides evidence that LDCs are less targeted by blended finance mechanisms. Only 8% of additional private capital was allocated to LDCs according to reporting by DAC donors in 2012-2017[74]. More efforts are needed to channel private capital to LDCs. Low-income countries require **additional** multilateral and bilateral donor **frameworks with regional and country focus** and private initiatives to push additional capital to LDCs. These frameworks should contain policy measures that take into consideration country and sector-specific challenges.

LDCs face serious capital distortions across sectors. Blended capital is mostly concentrated in revenue-generating sectors, confirming the trend noted by the UNCDF report[75]. In LDCs three sectors (energy, banking financial services, and industry, mining, construction) received more than 60% of mobilized private investments. Sectors like education, health, population policies, and disaster prevention are less financed with blended mechanisms. Sector targeting is very important given that most of SDGs are not bankable. Policymakers also face several dilemmas related to the proportion of public and private capital, the effectiveness of private capital in certain sectors, the balance between regulation and liberalization[76].

International organizations, bilateral donors, and private investors pursue different goals in development finance in LDCs. Aid flows to LDCs are characterized by fragmentation and a lack of coordination. The international community should provide clear priorities and targets for development finance and private sector engagements and coordinate their efforts to achieve the SDGs to avoid contradictions and strengthen complementarity. Development finance should be accompanied by capacity building and technical assistance of partner countries[77].
To sum up, a few recommendations could be made on how to make public and private frameworks aimed at private sector engagement for development more effective and LDC - oriented. First, unlike private initiatives, public frameworks

73 Impact measurement and management (2019). URL: https://thegiin.org/imm/
74 OECD data on private sector engagement is an estimate valid for 2019, 10 April. Statistical data for 2016-2017 is preliminary.
75 UNCDF (2018). Blended finance in the Least Developed Countries.
76 UNCTAD (2014). World Investment Report.
77 Ibid.

largely pursue consistency with institutional international initiatives, such as the Monterrey Consensus, the Paris Declaration, and the AAA, the AAAA, and others. Private initiatives also have a strong focus on the SDGs as a part of corporate social responsibility. Private and public frameworks could reinforce each other by establishing mechanisms to foster consistency and coherence.
Second, participation in the frameworks should be more transparent to all potential stakeholders. Easily understandable information should be distributed throughout relevant channels.
Third, most private and public frameworks lack an evaluation component needed to assess their key outputs. The GIIN is limited in its coverage of projects but the GPFI has more potential for developing methodologies and setting evaluation targets for LDCs.

Fourth, most private and public frameworks are not sensitive to LDCs' peculiar challenges, focussing more on the issues of general application to all developing countries.

The table below summarizes the key challenges associated with the current frameworks and provides recommendations on remedies to these challenges.

7.2 Mobilization of funds: supply side

The gap in financial resources needed to achieve the SDGs in LDCs represents a mere 0.03% of existing global financial assets. By the end of 2018[78] the total financial assets amassed by international frameworks aimed at catalyzing and scaling up private capital from domestic and international markets were estimated at $379 trillion (Figure 7.1). This amount of global accumulated assets significantly exceeds the gap for the implementation of the SDGs estimated at $2.5-$3.0 trillion annually. But only 0.002% of total global financial assets were mobilized and channelled to LDCs up to date.

The AAAA states that "For harnessing the potential of blended finance instruments for sustainable development, careful consideration should be given to the appropriate structure and use of blended finance instruments."

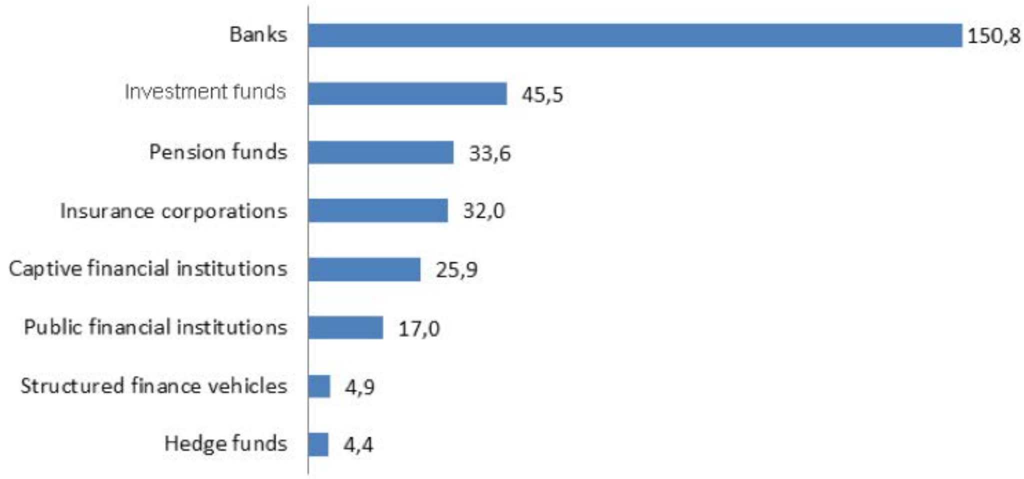
Table 7.3 - **Challenges and remedies of collective and individual initiatives**

Challenges	Remedies
Need for targeted approach on private capital engagement	Design initiatives and frameworks with regional and country focus on private capital engagement and SDGs investments in LDCs
Disparities in public/private capital mobilization by SDG and sectors	Develop guiding principles and framework of SDG investments by sector
Need for policy coordination among stakeholders	Establish coordination between initiatives and organizations
Lack of mutual reinforcement of private and public frameworks on business engagement for development	Create mechanisms to maintain consistency and linkages between the existing frameworks
Lack of transparency and information on participation and benefits of engagement with the private and public frameworks	Broadcast and disseminate the information among key stakeholders
Lack of evaluation component to assess the performance of activities supported by public and private framework	Incorporate M&E components into project implementation cycle.
Lack of focus of public and private frameworks activities on the markets of LDCs	Provide more stimulus for private sector to engage with the LDCs.

Source: compiled by authors.

78 Financial Stability Board (2020). Global Monitoring Report on Non-Bank Financial Intermediation 2019.

Figure 7.1 - **Selected components of financial assets ($ trillion)**



Source: Financial Stability Board (2019). Global Monitoring Report on Non-Bank Financial Intermediation 2018.

It is silent on the specific approaches on private capital mobilization that might be needed for LDCs. However, it can be inferred that the AAAA recognizes that not all innovative financing instruments are suitable for the LDCs and that private sector instruments should be adapted to the peculiar environment of LDCs.
Another problem that arises from the mobilizing of additional investments is connected with market failures and the pro-cyclical nature of private capital whereby capital markets shrink and capital withdraws during crisis periods. The implementation of the SDGs requires stable and growing inflows of development capital. Thus, blended finance mechanisms should be adapted to provide counter-cyclical instruments for LDCs.

The development of SDG targeted tools, blended mechanisms and instruments and the expanding number of actors will contribute to the emergence of special financial intermediation for the purposes of the SDGs and the development and expansion of capital markets for sustainable development. Donors can facilitate the emergence of a framework and agreement on priorities for such market development.

7.3 Mobilization of funds: demand side

Due to the lack of transparency on projects, accounting problems, and possibly the time lag between the attraction and investment of capital,

Table 7.4 - **Challenges and remedies of mobilization**

Challenges	Remedies
Not all blended mechanism instruments are adapted for LDCs	Design of dedicated financial mechanisms and instruments for LDCs and SDGs using revenue incentives and risk mitigating tools
Mechanisms do not mitigate pro-cyclical nature of private capital	Design of counter-cyclical initiatives for LDCs
Lack of established capital markets for sustainable development	Foster framework and agreed priorities for capital markets for sustainable development

Source: compiled by author.

there is little available evidence of the transformative impact or channelling of attracted capital in the implementation of SDG-specific development projects, especially in LDCs. It is thus difficult to build a comprehensive picture of the demand side of the mobilization effort.

The capital market for sustainable development is growing in terms of volume of operations, number of new participants and innovative financial instruments. One the fastest growing markets is debt securities (green bonds, social impact bonds, SDGs bonds). This market is open only for creditworthy developing countries. Only 18 LDCs out of 47 have received a credit rating (even default rating) from at least one international rating agency (Table 7.3). The absence

of credit ratings for most LDCs excludes them from the market for green bonds. Moreover, the scale of potential climate projects is too small for the minimum size of green bonds issues[79].
One of the possible strategies to overcome this reality is to use the intermediation of the DFIs to issue bonds to satisfy LDC capital needs. As the bond market becomes more targeted, there is added scope to create financial mechanisms dedicated exclusively to the challenges of the least developed countries.

Table 7.5 - **Least developed country long-term ratings in foreign currency**

Least developed country	Standard and Poor's	Moody's	Fitch
Angola	B-	B3	B
Bangladesh	BB-	Ba3	BB-
Benin	B+	B2	B
Burkina Faso	B	-	-
Democratic Republic of the Congo	CCC+	B3	CCC
Cambodia	-	B2	-
Ethiopia	B	B1	B
Gambia	-	-	B-
Lesotho	-	-	B+
Malawi	-	-	B-
Mali	-	B3	B-
Mozambique	SD	Caa3	RD
Rwanda	B	B2	B+
Senegal	B+	Ba3	-
Solomon Islands	-	B3	-
Uganda	B	B2	B+
United Republic of Tanzania	-	B1	-
Zambia	B-	Caa1	B-

Source: Standard and Poor's, Moody's, Fitch.

Among the challenging issues of LDC countries is weak financial intermediation and poor development of capital markets. The rate of domestic credit to the private sector in LDCs is very low (except for Asian LDCs). More than half of LDCs have ratios of domestic credit to private sector less than 20% of GDP, demonstrating acute shortages in liquidity[80]. The weakness of domestic capital markets and lack of financial infrastructure renders existing innovative financial instruments largely inapplicable in LDCs. The participation of domestic private capital in development finance is also limited. Institutional development of capital markets and financial intermediation could be one the targets of reforms in LDCs.
The planning of SDGs implementation should be based on sector development priorities and have a cumulative effect on the overall growth of the economy and fiscal revenues. The demand for financial resources also has some constraints in terms of the potential to absorb private investments across different sectors. Some sectors are also

79 Banga J. (2019): The green bond market: a potential source of climate finance for developing countries. Journal of Sustainable Finance & Investment. Volume 9.
80 World Development Indicators database.

characterized by few investment opportunities. LDCs will need to coordinate mobilization capacity across sectors and oversee local initiatives with multilateral and bilateral donors. Mobilized private investments will likely demand increasing public expenditures, which are already constrained by weak tax bases and tax administrations and significant size of informal sectors in LDCs. The growth of fiscal expenditures is impossible without the development of the local economy, the reduction of the informal sector, an increase in tax collection and other measures to increase budget revenues. Such measures should accompany the increase in blended finance inflows[81].

Another issue concerns the different priorities of the recipient countries on the balance of public/private capital in the industry or service sector. In sectors characterized by predominantly public ownership, the demand for PPP or blended finance mechanisms may not be high. In other sectors, for example, telecommunications or financial sector, private capital investments can often be targeted to enhance their efficiency[82]. However, it is desirable that domestic private participation should not be addressed only through increasing access to the financial services to the customers, but also by the development of competition and a reduction in the cost of capital.

7.4 Channeling of mobilized private capital

Weak -investment climates and other investment barriers are serious obstacles to channeling mobilized private capital to LDCs[83]. According to the Doing Business Rankings, LDCs have unfriendly investment climates with most achieving rankings in the 3rd and 4th quartile overall and in selected components of the index[84]. Improvement of the investment climate and its components (infrastructure, access to finances, taxes, investors' protection, property rights, etc.) is considered crucial for the implementation of the AAAA and mobilization of additional private capital.

Table 7.6 - **Challenges and remedies of mobilization (demand)**

Challenges	Remedies
Weak capital markets	Capital markets reform and development of domestic financial intermediation; design and application of instruments suitable for LDCs
Budget constraints or debt burden	Expand tax bases; long-term planning of SDGs implementation
Balancing public/private participation	Framework for sectoral priorities for private capital attraction
Few investment opportunities across countries or sectors	Planning of mobilization across sectors and countries; strengthen institutional capacities of LDCs; closer cooperation and effective partnerships with donors

Source: compiled by author.

Currency risks are also the challenge for international investors in LDCs. Many developing and emerging countries' local currencies are subject to sometimes multiple devaluations. For example, the Angolan Kwanza to US Dollar has been devalued more than 18 times since 2000 and the Zambian Kwacha lost more than 80% of its value since 2014[85]. LDCs often lack hedging instruments, which creates a serious barrier for international investors. The AAAA encourages borrowings and lending in local currencies by multilateral development banks but currency risks limit the development of domestic financial intermediation.

81 UNCTAD (2018). Achieving the Sustainable Development Goals in the Least Developed Countries: A Compendium of Policy Options.
82 UNCTAD (2014). World Investment Report.
83 Ibid.
84 UNCDF (2018). Blended Finance in the Least Developed Countries.
85 International financial statistics. URL: data.imf.org/ifs

International capital market actors lack knowledge and experience of LDC business environments and this represents an additional challenge to channel investments to these countries. Moreover, international investors do not have enough expertise on SDG-related capital mobilization and expenditures. Private flows need to be accompanied by partnerships with official donors as well as by technical assistance which can strengthen the expertise of investors and foster private sector investments in LDCs.

One possible remedy is to channel additional private capital through national or sub-regional development banks since most LDCs still do not have national development banks or they lack the requisite scale to be effective in their operations. Sub-regional development banks can become the main hubs for blended operations in their sub-regions[86] filling the financial gap in beneficiary countries but also acting as financial intermediaries to channel private capital to SDG-related projects. They can leverage their regional expertise to promote private investments in bankable projects at less risk for beneficiary countries. Sub-regional development banks also have the advantage of applying different instruments to cover residual risks connected with poor investment climates or exchange rate volatility.

7.5 Risks associated with SDG project implementation

Development projects implemented by donors and engaged private capital face several challenges.

Table 7.7 - **Challenges and remedies of channelling mobilized private capital**

Challenges	Remedies
Lack of investor knowledge and expertise on LDCs and SDGs	Partnerships with official donors and technical assistance Leverage expertise of regional/sub-regional development banks
Unfriendly investment climate and currency risks	Improvement of investment climate and its components Leverage regional/sub-regional development banks intermediation
Other barriers to private investments	Practical measures to enhance entry of SDG-targeted capital

Source: compiled by author.

They often lack coherence between donor sector prioritization, SDGs synergies and project timeframes. SDGs are interlinked, which may imply sequential implementation and simultaneous investments that could impose considerable pressure on LDC national budget expenditures.

The implementation of the SDG-related projects can be associated with impact risks. Concerted efforts are needed on the part of national governments in collaboration with other stakeholders, including donors and the private sector to encourage development impact of the projects including good governance, capacity building, dialogue with beneficiary countries. Negative spill-over effects should be taken into consideration during the realization of large-scale projects, which can withdraw multiple resources from other sensitive sectors or areas of development policy. The systematic approach that takes in consideration governance, project evaluation and spill-over-effects estimation should be applied for project implementation to minimize risks and promote structural transformation in LDCs.

7.6 Challenges of impact evaluation

The evaluation of the results of blended finance operations is important for understanding the effectiveness of individual instruments and

[86] AfDB (2015). The Study Report on the Assessment of African sub-Regional Development Banks' Contribution to Infrastructure Development.

Table 7.8 - **Challenges and remedies of risk in the implementation of mobilized private capital**

Challenges	Remedies
Lack of expertise and coordination of SDG investments	Increase coordination capacity of national governments
Lack of synergies or inconsistent investments	Coordination and oversight by national governments between and across various development stakeholders and actors
Negative spill-over effects of implementation	Better account and mitigation of negative impact risks of SDG projects

Source: compiled by author.

the short and long term effects of private sector engagement. It is necessary to improve donors' blended finance policies and allocation strategies. The evaluation of the development results of blended finance would also facilitate better understanding of the extent to which such interventions contribute to the achievement of the SDGs. The formulation and evaluation of the results of private capital mobilization is still not well accounted for by donors. For instance, the DAC framework for monitoring blended finance requires harmonization and improvement. Pre-Agenda 2030, some donors estimated the level of capital leverage, role of private capital in co-financing and participation in PPP on an irregular basis. With the rising importance of private capital in development finance, donors have introduced new parameters for the regular monitoring of private sector engagement. Nowadays, there is a wide range of undertakings by national governments, multilateral development banks and academic institutions to evaluate the business' development footprint.

In response to the Addis Ababa Action Agenda, donors started not only to estimate the volume of mobilized private capital but also set quantity-based targets. For example, the African development bank (AfDB) monitors, on a regular basis, the volume of resources mobilized from private sector entities. In line with Its Strategy 2013–2022 and One Bank Results Measurement Framework it sets a target to mobilize additional resources from private entities. The AfDB targets to raise $90 billion during 2016-2025[87]. In 2017 the bank realized only $4 billion in additional resources mobilized from the private sector, which was below the $9 billion annual target it set for itself[88].

Financial and development additionality. The result orientation of private sector operations should be based on the principle of the financial additionality of private capital and its development additionality. But the definition of both financial and development additionality is still not harmonized among donors. The notion of financial additionality assumes that private capital will be invested without official donors' support. This causality is rather difficult to prove and is also a "subjective exercise"[89]. Development additionality is considered to be the additional development outcomes that arise from blended finance i.e. that would not have materialized otherwise. These additional development outcomes may encompass an increase in the scale of the project, enhanced impact or a shorter period of time needed for project realization[90]. Donors, especially development financial institutions, apply financial additionality rather than development additionality. The lack of a common approach towards additionality creates several challenges, including the lack of a common methodology to prove additionality. Moreover, there remains the need to understand whether blended finance is the best approach for a project and if concessional funds were not drawn away from other programmes.

Monitoring. A reliable monitoring system is essential for impact evaluation. In the case of blended finance it faces several challenges:

- The existence of several tiers of capital delivery

87 AfDB (2018). Annual Development Effectiveness Review 2018.

88 Ibid.

89 Du Monceau T., Brohé A. (2011). Baseline Setting and Additionality Testing within the Clean Development Mechanism. Center for European Policy Studies.

90 OECD (2016). Private sector Peer Learning. Peer Inventory 1.

(governments, development institutions, MDBs, private providers) may be hampered by a resistance to sharing results.

- It often ends with the financial intervention whereas the evaluation of development impact requires monitoring beyond the project life-cycle. According to an OECD survey, only 20% of blended finance funds and facilities collect data one year or more after financial intervention[91].
- Not all data is made public, due to confidentiality issues.

Donors should initiate the process of enhancing ***transparency of evaluation results***.

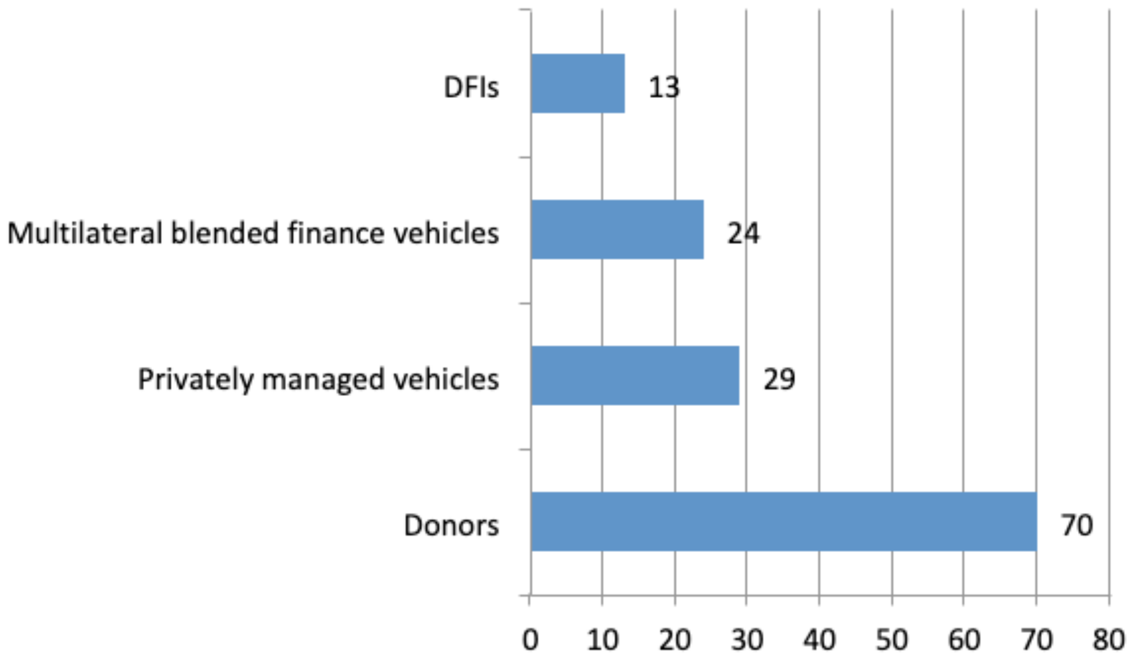
Institutional organization. DFIs and national governments have a keen interest in attaining development results. However, most of them have not fully or clearly articulated their approach on measuring the development impact of private sector involvement. The main argument for this is that they have different systems for project planning, monitoring and evaluation. Moreover, impact evaluation is often separated from the project selection and planning stage such that the project's impact on development priorities is unclear when the project is selected and implemented.

The delivery of blended finance may involve several intermediaries with different approaches to the monitoring and evaluation of the results, thus creating a serious problem for governance and accountability of the projects[92].

Evaluation coverage. According to an OECD Survey, 70% of blended finance actors undertake evaluations on a regular basis. Donor instruments are evaluated more frequently and have better coverage than blended finance facilities and funds[93]. Private providers of blended finance are not obliged to evaluate the projects. Most evaluations provided by private funds and facilities are undertaken on a voluntary basis. The evaluation reports of most blended finance actors are for internal purposes and are not made public, except to bilateral donors (See Figure 7.2). Donors should encourage private fund facilities and other private investors to publicize their project evaluation reports and elaborate a ***framework of evaluation for private investors.***

Development impact evaluation methods and gaps. Due to the nature of blending mechanisms, donors' estimate the volume of required financing and expected development impact based on a case by case approach[94].

Figure 7.2 - **Dissemination of evaluation reports, %**



Source: OECD (2018). Making Blended Finance Work for the Sustainable Development Goals

[91] OECD (2018). Making Blended Finance Work for the Sustainable Development Goals.

[92] Winckler Andersen, O., et al. (2019), "Blended Finance Evaluation: Governance and Methodological Challenges", OECD Development Co-operation Working Papers, No. 51, OECD Publishing, Paris,

[93] OECD (2018). Making Blended Finance Work for the Sustainable Development Goals.

Existing frameworks for monitoring and evaluation of blended finance allow donors to estimate output (private sector engagement, instruments, countries and regions, spheres of capital allocation) rather than impact. Donors, especially development finance institutions, thus estimate the financial aspects of the project rather than the direct impact of the project. For example, they use indicators such as the number of new jobs created, energy capacity, tax revenues, or other metrics in line with Impact Reporting and Investment Standards (IRIS).[95]

Estimating the contribution of private blended finance to the achievement of the SDGs requires the evaluation of indirect impact and spill-over effects of these instruments. Such an evaluation methodology requires systematic investments as well as complex evaluations[96] because it is difficult to prove the causality between financial interventions and impact.[97]

An approved methodology for evaluation of new blended finance instruments does not exist and a reliable evidence base of blended finance (guarantees, collective investment vehicles) efficiency does not exist.

Donors should encourage the elaboration of **common evaluation principles** both for bilateral and multilateral donors to ensure the comparability of results. Bilateral and multilateral donors pursue different goals (mostly financial) of evaluation practice. There is a need for **a results measurement framework** to estimate the impact of financial interventions. This also includes the necessity of **monitoring projects a year or more after the financial investment.** Donors should also initiate a process of enhancing **transparency of evaluation results**. Impact evaluation rarely considers beneficiary countries feedback. Donors should **stimulate beneficiary countries feedback** in order to adapt their aid system to respond to the needs of recipients.

The evidence base. Analysis for Economic Decisions (ADE) evaluated the effectiveness of EU blending mechanisms[98]. The objective of the exercise was to evaluate how and to what extent EU blending contributed to achievement of objectives set[99]. The evaluation report addresses mainly operational and financial effectiveness aspects of EU blended finance operations, rather than its impact on beneficiary country. For example, the report does not give an exact answer on whether the level of grant interventions was appropriate, provide information on capital leverage or provide information about causality.

The European Court of Auditors evaluated blending facilities of financial institutions that support EU external policies[100]. The Court found that in 15 out of 30 projects cases, the blending was not necessary and there were indications that the financial institution would not have provided investment without official support.

There evidence is poor on how blended finance can contribute to the achievement of the SDGs.[101] DAC members are organizing a working group to coordinate the evaluation of blended finance projects and instruments, which will contribute to more effective policy decisions on capital allocation. Donors should encourage the evaluation of projects pursued by investors for both development and commercial goals to create a **larger evidence base**.

---

94 European Court of Auditors (2014). The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies

95 Savoy, C.M. et al. (2016). Development Finance Institutions Come of Age - Policy Engagement, Impact, and New Directions. A Report of the CSIS Project on Prosperity and Development and the Overseas Development Institute (ODI). October 2016.

96 OECD (2018). Making Blended Finance Work for the Sustainable Development Goals.

97 OECD (2016). Development Co-operation Report 2016: The Sustainable Development Goals as Business Opportunities.

98 European commission (2016). Evaluation of blending. Final Report.

99 Ibid.

100 The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies.

101 OECD (2018). The next step in blended finance: addressing the evidence gap in development performance and results. Workshop report.

Table 7.9 - **Challenges and remedies for gaps in impact evaluation**

Challenges	Remedies
Little evidence exists on the results of projects financed by blended instruments	Establish larger evidence base
Lack of harmonized methods of evaluation	Elaborate common evaluation principles
Different goals and evaluation practice	
among donors	Design common results measurement framework
Short-term monitoring of results hampers impact evaluation	Monitor project results beyond financial investment timeframes
Beneficiary country feedback rarely considered	Incorporate beneficiary countries' feedback in project evaluation
Private providers of blended finance are not obliged to evaluate their projects	Establish framework for impact evaluation by private investors
Evaluation reports are not publicized	Encourage public dissemination of evaluation results

Source: compiled by author.

Concluding remarks

This paper has reviewed the evolution of private sector engagement before 2015 and during the process of implementation of the Agenda 2030. Private sector engagement became a target in implementation of the Agenda 2030 but the private sector also an important actor in development cooperation.

The concept of private sector engagement is based on the principles of financial and development additionality which are understood differently by members of the donor community. The lack of coordination on private sector engagement hampers the effective implementation of the Agenda 2030.

Blended finance operations have limited influence on LDCs' economies due to the small scale of projects in these countries. Guarantees account for the biggest share of private sector instruments in LDCs and do not result in real financial flows from official resources. Across all income groups, low-income countries are the least involved in decisions on the allocation of mobilized additional private capital. Such a trend throws doubt on the effective role of the private sector in the implementation of the SDGs in LDCs.

The paper has summarized the challenges and gaps of the post-2015 development cooperation framework on private development finance. The paper analysed the various aspects of private capital allocation, including the push factors for public and private initiatives, the supply and demand sides of the mobilization, channeling and implementation of private capital, and project impact evaluation.

Weak financial intermediation, risky investment environments, entry barriers, low absorbability of investments as well as low expertise of private entities in SDGs create serious risks for the mobilization and channelling of additional private capital to LDCs. Concerted and coordinated efforts by national governments and stakeholders need to promote the implementation of the SDGs and to keep the balance of private and public investments in line with the interests of beneficiary countries.

There remains little evidence on the effectiveness and impact of blended finance instruments due to the lack of relevant research. This impedes decision making on additional private capital allocation to promote structural in LDCs. However, current deliberations on blended finance principles, supported by the OECD, contribute to the development of a practical basis in this field (see Box 2).

Box 2 – **Blended Finance Principles**

Principle 1. Anchor blended finance use to a development rationale
Principle 2. Design blended finance to increase the mobilization of commercial finance
Principle 3. Tailor blended finance to local context
Principle 4. Focus on effective partnering for blended finance
Principle 5. Monitor blended finance for transparency and results

Source: OECD, 2020.

The work undertaken by the OECD is currently in progress. The tentative principles should be further discussed among a wide range of stakeholders to foster their adoption as soft recommendations by the broader international community.

[102] OECD (2020) Blended Finance. URL: https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/

Bibliography

Addis Ababa Action Agenda (2015).

AfDB (2018). Annual Development Effectiveness Review 2018.

AfDB (2015). The Study Report on the Assessment of African sub-Regional Development Banks' Contribution to Infrastructure Development.

Banga J. (2019): The green bond market: a potential source of climate finance for developing countries. Journal of Sustainable Finance & Investment. Volume 9.

BCG (2019). Global Asset Management 2019: Will These '20s Roar? . URL: https://www.bcg.com/publications/2019/global-asset-management-will-these-20s-roar

Birdsall N., Brian D. (2001). Multilateral Development Banks in a Changing Global Economy. Economic Perspectives. Electronic Journal of the U.S. Department of State.

Boehmer H.M., Zaytsev Yu.K. (2019). Raising aid efficiency with international development aid monitoring and evaluation systems. Journal of multidisciplinary evaluation. Vol. 15, N 32

Bresser-Pereira L.C. and Bechelaine C. (2019). Multilateral development banks, new developmentalism and local currency financing. Brazilian Journal of Political Economy. 39, 4, 755-767. DOI: https://doi.org/10.1590/0101-31572019-2980.Carter P. (2015) Why Subsidise the Private Sector? What donors are trying to achieve, and what success looks like? ODI Report. P. 48.

CECP (2019). Giving in Numbers. URL: https://cecp.co/home/resources/giving-in-numbers/Dasgupta

D., Dilip R. (2000). "What factors appear to drive private capital flows to developing countries? And how does official lending respond?", World Bank Policy Research Working Paper, no 2392.

Du Monceau T., Brohé A. (2011). Baseline Setting and Additionality Testing within the Clean Development Mechanism. Center for European Policy Studies.

EIB (2014) Annual Report on EIB activity in Africa, the Caribbean and Pacific, and the overseas territories.

EU External Investment Plan (2017). URL: https://ec.europa.eu/commission/eu-external-investment-plan/what-eus-external-investment-plan_en

EU External Investment Plan (2019). Factsheet. URL: https://ec.europa.eu/commission/sites/beta-political/files/external-investment-plan-factsheet_en.pdf

Eurodad (2007). Public development banks: towards a better model.

European commission (2016). Evaluation of blending. Final Report.

European Court of Auditors (2014). The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies.

Financial Stability Board (2020). Global Monitoring Report on Non-Bank Financial Intermediation 2019.

Financial Stability Board (2019). Global Monitoring Report on Non-Bank Financial Intermediation 2018.

Galindo A.,Panizza U. (2018). The cyclicality of international public sector borrowing in developing countries: Does the lender matter?, World Development, Vol. 112(C), 119-135.

G20 Principles for Innovative Financial Inclusion (2010). URL: https://www.gpfi.org/sites/gpfi/files/documents/Principles%20and%20Report%20on%20Innovative%20Financial%20Inclusion_0.pdf

GIIN (2018). Annual Impact Investor Survey.

GIIN (2019). Global Impact Investing Network's. URL: https://thegiin.org

GIIN (2020). Annual Impact Investor Survey.

GPFI (2019). The G20 Global Partnership for Financial Inclusion Green bonds (2019).

Green bonds. The State of the Market 2018.

Gulrajani, N. (2015) Bilateral versus multilateral aid channels: Strategic choices for donors. ODI Working Paper. London.

Humphrey C. (2017). He Who Pays the Piper Calls the Tune: Credit Rating Agencies and Multilateral Development Banks. Review of International Organizations, 12, 281–306.IFC (2002). IFC and its role in globalization.

Humphrey C (2020). All hands on deck: How to scale up multilateral financing to face the Covid-19 crisis.

Emerging analysis and ideas. Overseas Development Institute (ODI). London.

IFC (2018). Understanding DFIs' Private Sector Engagement in African Fragile and Conflict-Affected Situations.

Inter-American development bank (2002). Annual report 2001.

J.P.Morgan, GIIN (2014). Spotlight on the Market. The Impact Investor Survey.

Kellerman, M. The proliferation of multilateral development banks. The Review of International Organizations 14, 107–145 (2019). https://doi.org/10.1007/s11558-018-9302-y

KfW (2016). C. Colia. Mobilisation of private capital What contribution can development banks make. Perspectives on Development Financing. #4.

Kindornay S., Reilly-King F. (2013). Investing in the business of development. The North – South Institute. Canada.

Lerrick, A. (2006). Has the World Bank Lost Control? In Rescuing the World Bank: A CGD Working Group Report & Selected Essays, ed. Nancy Birdsall, pp. 117– 132. Washington, DC.: Center for Global Development.

Meltzer, A. (2000). Report of the International Financial Institution Advisory Commission. Prepared for the U.S. Congress. Washington, DC.

Miller, H. (2013). What practical approaches/frameworks are there for effectively delivering subsidy to private sector entities for development purposes?'. Economic And Private Sector, Professional Evidence And Applied Knowledge Services [EPS-PEAKS].

Multilateral Development Banks' Harmonized Framework for Additionality in Private Sector Operations. (2018).

OECD (2014) Development Co-operation Report 2014: Mobilising Resources for Sustainable Development.

OECD (2016). Development Co-operation Report 2016: The Sustainable Development Goals as Business Opportunities.

OECD (2016). High Level Meeting. Communique. February, 19.

OECD (2016). Private sector Peer Learning. Peer Inventory 1.

OECD (2018). DAC methodologies for measuring the amounts mobilised from the private sector by official development finance interventions.

OECD (2018). Making Blended Finance Work for the Sustainable Development Goals.

OECD (2018). Measuring the results of private sector engagement through development co-operation.

OECD (2018). Report on the DAC untying recommendation.

OECD (2018). The next step in blended finance: addressing the evidence gap in development performance and results. Workshop report.

OECD (2019). Amounts Mobilized from the Private Sector by Development Finance Interventions in 2012-17. Preliminary insights from the data.

OECD (2019). In-donor refugee costs reported as ODA by OECD-DAC members URL: http://www.oecd.org/dac/financing-sustainable-development/In-donor-refugee-costs-in-ODA.pdf

OECD (2020). Amounts mobilized from the private sector by official development finance interventions in 2017-18. URL: https://issuu.com/oecd.publishing/docs/amounts-mobilsed-from-the-private-sector-by-dev-fi

OECD (2020). Official development assistance – definition and coverage. URL:https://www.oecd.org/dac/stats officialdevelopmentassistancedefinitionandcoverage.htm

PSE (2019). USAID policy on private sector engagement.URL:https://www.usaid.gov/work-usaid/private-sector-engagement

Savoy, C.M. et al. (2016). Development Finance Institutions Come of Age - Policy Engagement, Impact, and New Directions. A Report of the CSIS Project on Prosperity and Development and the Overseas Development Institute (ODI). October 2016.

SDIP (2019). Sustainable Development Investment Partnership. URL: http://sdiponline.org/

The Future Role of the Private Sector in Development Cooperation: an overview of key policy processes. CONCORD. Swedish and European CSOs for global development. June 2014.

The Monterrey Consensus on financing for development. URL:https://www.un.org/en/development/desa/population/migration/generalassembly/docs/globalcompact/A_CONF.198_11.pdf

UN (2019). UN Secretary General's Roadmap for Financing the 2030 Agenda for Sustainable Development 2019 – 2021. URL: https://www.un.org/sustainabledevelopment/wp-content/uploads/2019/07/UN-SG-Roadmap-Financing-the-SDGs-July-2019.pdf

UN-Business Focal Point Newsletter Issue 16 (November 2011). URL: https://business.un.org/en/documents/10252

UNCDF (2018). Blended finance in the Least Developed Countries.

UNCTAD (2014). World Investment Report.

UNCTAD (2018). Achieving the Sustainable Development Goals in the Least Developed Countries: A Compendium of Policy Options.

United Nations (2010). Coming of age: UN-private sector collaboration since 2000. United Nations Global Compact Office. New York.

WEF, OECD (2016). Insights from Blended Finance Investment Vehicles & Facilities.

Wang H. New Multilateral Development Banks: Opportunities and Challenges for Global Governance. Global policy, Vol. 8, Issue 1, 113-118

Winckler Andersen, O., et al. (2019), "Blended Finance Evaluation: Governance and Methodological Challenges", OECD Development Co-operation Working Papers, No. 51, OECD Publishing, Paris.

World bank (2017). Otsenka programm sodeystviya sotsialno-ekonomicheskomy razvitiu. [Evaluation of International Development Assistance Programs]. URL: http://documents1.worldbank.org/curated/pt/511701510069440738/pdf/120993-%D0%A3%D1%87%D0%B5%D0%B1%D0%BD%D0%BE%D0%B5-%D0%BF%D0%BE%D1%81%D0%BE%D0%B1%D0%B8%D0%B5-%D0%9C%D0%B8%D0%9E-2017.pdf