WARWICK
THE UNIVERSITY OF WARWICK

EXECUTIVE SUMMARY

Blended finance instruments are promoted as a means of scaling up resources to meet the Sustainable Development Goals (SDGs) by using public and philanthropic resources to mobilise private capital for financing global public goods. This brief explores how the expansion of blended finance without consideration of broader regulatory and governance implications can undermine sustainable development in four ways: fragmenting the aid architecture, weakening accountability and community safeguards, undermining the ownership of policies by countries and communities, and creating new risks in the international financial system.

The Risks of Using Blended Finance in Development

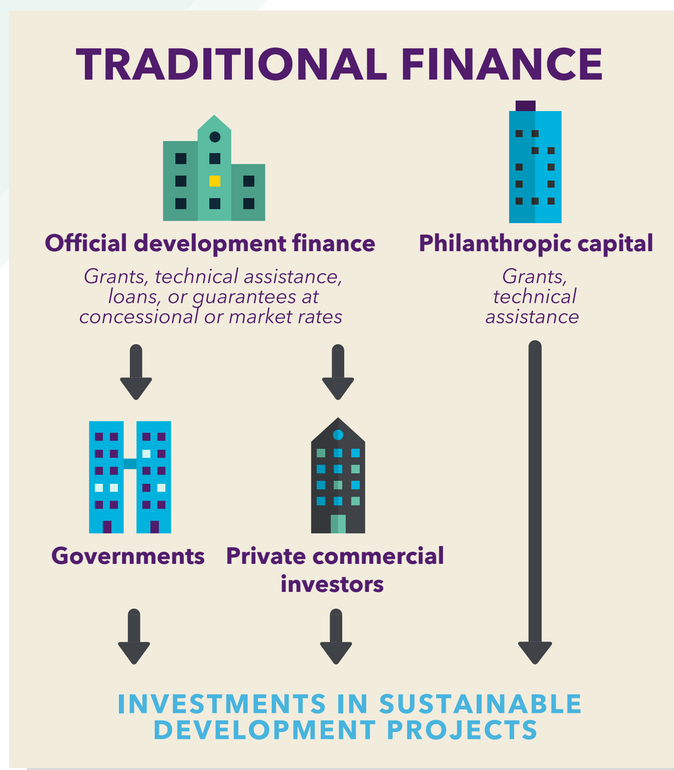
Dr Celine Tan

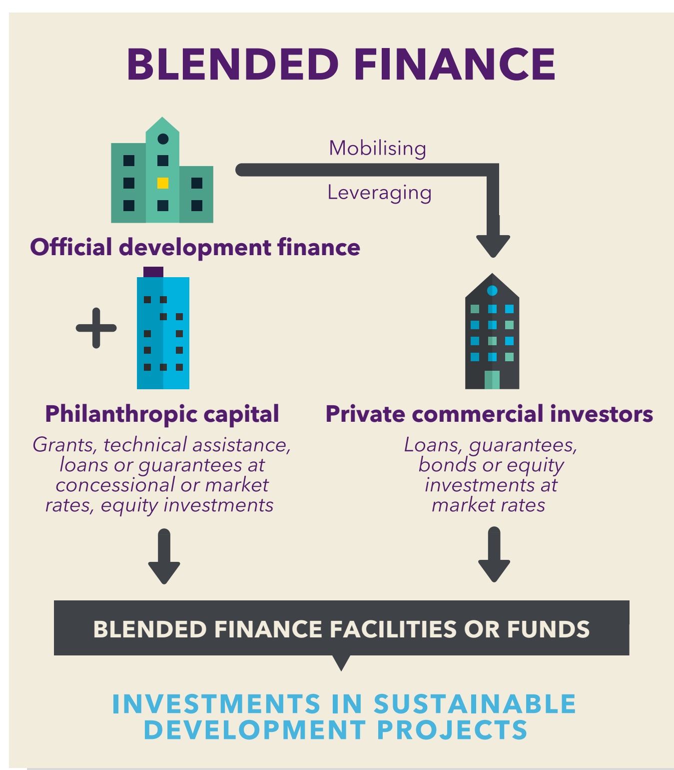
POLICY BRIEF #4

GLOBE CENTRE OCTOBER 2018

Blended finance instruments pool aid/public finance from national or international development agencies, philanthropic or charitable resources and/or capital from commercial sources (i.e. banks, investment funds, private equity firms, and companies) to fund sustainable development projects.

Their aim is to encourage private investments by reducing risks and improving returns for investors in SDG-related sectors, such as road and energy infrastructure, healthcare, banking and financial services, education, water and sanitation, and climate change adaptation and mitigation.





Without adequate regulatory considerations, blended finance can undermine the long-term effectiveness and sustainability of international development in four ways:

1) Fragmenting aid governance

Blended finance will disperse development finance across more facilities and organisations and complicate efforts to map, track and account for global financial flows for development. There are currently no harmonised monitoring and evaluation systems or standardised reporting mechanisms for blended finance. This has implications for: a) monitoring decision-making processes; b) the transparency of financial disbursements and procurement of goods and services; and c) overseeing the implementation of development policies and projects.

2) Accentuating accountability gaps

Blended finance arrangements sit uneasily within an accountability framework established for official development finance.

Most official development agencies have developed internal administrative regimes to mitigate the environmental and social harms of development projects. For example, International Finance Corporation projects are governed by its Performance Standards on Environmental and Social Sustainability, while communities have access to the Office of the Compliance Advisor for dispute resolution. Bilateral development agencies, such as the UK's Department for International Development and its private sector financing arm, the CDC, are also governed by national administrative law and judicial review mechanisms.

Blended finance projects are likely to be regulated by more disparate corporate accountability frameworks. The design and implementation of corporate codes of conduct and private sector grievance mechanisms often fall short of the standards established by the public sector. These mechanisms tend to have limited operational independence from their project sponsor and often lack third-party review and verification.

Oversight of blended finance is likely to fall on domestic legal and regulatory frameworks. This can be challenging in countries where corporate governance regimes remain weak and/or public administrative structures are under-resourced.

BETWEEN 2000 AND 2016[1]

167 BLENDED FINANCE FACILITIES LAUNCHED

US$31 BILLION IN FINANCIAL COMMITMENTS

3) Undermining country ownership

The involvement of private entities in decisions relating to the allocation and use of official resources can create tensions between commercial interests and/or philanthropic motives and the public mandates for sustainable development. Blended finance projects concentrate in economic sectors that are profitable for commercial investors and neglect other areas in greater need of funding *(see figure on the right).*

Many hybrid financing platforms are used for policymaking and standard-setting on various sustainable development issues. This places private actors in prominent decision-making spaces without accompanying accountability mechanisms. Blended finance facilities tend to have less scope for meaningful participation from developing country governments and communities, contrary to the OECD Paris and Accra Declarations on Aid Effectiveness.

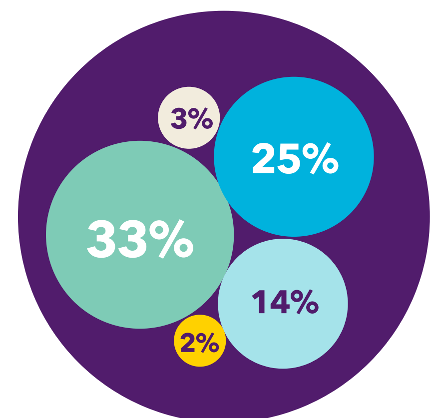
4) Creating new financial risks

Blended finance taps into financial markets and creates novel financial instruments for funding development projects, including the conversion of public utilities and infrastructure projects into tradable assets to be bought and sold by private investors. This may not be a reliable or sustainable mode of long-term financing, especially if public finance is being used to 'de-risk' projects to encourage private investments.

Recent experience in industrialised countries has highlighted the precarity of relying on private investors to construct and deliver public infrastructure and services. When private investments fail, it usually falls on the public funds to mitigate disruption to public services. This may not be an option for resource-strapped developing countries.

Moreover, without significant regulatory safeguards, there is also a danger that the development and use of blended finance can generate new transmission channels for financial crises in developing countries and lead to a greater build-up of sovereign debt that can severely impact the attainment of the SDGs.

PRIVATE FINANCE MOBILISED BY OFFICIAL DEVELOPMENT FINANCE BETWEEN 2012-2015[2]



- **Banking and financial services US$27.1 billion**
- **Energy US$20 billion**
- **Industry and manufacturing US$11.5 billion**
- **Health US$2 billion**
- **Water and sanitation US$1.5 billion**

References
[1] OECD, Making Blended Finance Work for the Sustainable Development Goals, 2016.
[2] OECD, Amounts Mobilised from the Private Sector by Official Development Finance Interventions, 2016, Available online.

POLICY RECOMMENDATIONS

1. Include blended finance in the broader toolkit of financing to meet the SDGs and not as a substitute for official loans, grants, and guarantees.
2. Strengthen the monitoring and evaluation systems and environmental and social safeguards policies for blended finance arrangements.
3. Ensure that blended finance arrangements adhere to the OECD Principles on Blended Finance and the Paris and Accra Agenda for Aid Effectiveness.
4. Ensure that private actors receiving public funds to finance public goods are subject to the same scrutiny and financial and operational disclosure as public entities.
5. When using blended finance take into account legal and financial risks, including countries' debt sustainability and the sustainability of blended financial flows.

Dr Celine Tan
Associate Professor of Law. Director of the Centre for Law, Regulation, and Governance of the Global Economy (GLOBE), University of Warwick. Her research focuses on international development financing law, policy and governance, international financial regulation and the law and governance of sovereign debt. Dr Tan is interested in the intersection between law, development, gender, human rights and the environment. For publications visit: *warwick.ac.uk/fac/soc/law/people/Celine_Tan*.

celine.tan@warwick.ac.uk
globe@warwick.ac.uk

Tan, C. (forthcoming) 'Creative Cocktails or Toxic Brews? Blended Finance and the Regulatory Framework for Sustainable Development', in Gammage, C and Novitz, T (eds), *Sustainable Trade, Investment, and Finance: Toward Responsible and Coherent Regulatory Frameworks,* Edward Elgar.

For the full series visit:
http://go.warwick.ac.uk/globe/policybriefs

This policy brief series was created in collaboration with Research Retold www.researchretold.com.

@CelineCLTan
@GlobeWarwick