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Community Paper

From Funding to Financing
Transforming SDG finance for country success

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Introduction

The current gap in global development financing is significant, with an annual estimated investment requirement of $2.5 trillion.[1] Beyond the global agreements that countries sign up to, such as the Sustainable Development Goals (SDGs) or the Paris Climate Agreement, most developing countries are acutely aware of the very practical challenges they face putting their development goals into action and getting the funding to enable those investments to proceed. Not only governments, but also populations, and in particular the younger generations, are demanding action, but the level of investment needed to achieve the SDGs far surpasses government budgets, tax revenues and development-related aid.

The financing of the SDGs will require a move from project funding to financing. In this context, mobilized private capital, from domestic and international sources, will need to complement an efficient allocation of public finance. It will also require a steady pipeline of projects that help countries meet their sustainable development objectives. National governments face trade-offs as they consider how best to: (1) allocate their own resources to support sustainable development; (2) use the development finance architecture and related cooperative platforms to fund and finance these projects; and (3) tap into and marshal private sources for sustainable development.

This paper seeks to lay out background considerations related to these issues, describing recent progress in the world of development finance, identifying key gaps, and outlining a short list of actions and potential solutions to be taken up by the Global Future Council on Development Finance. The goal is also to solicit feedback from the development finance community and encourage engagement by various stakeholders in advancing solutions.

The issue: Moving from ‘funding’ to ‘financing’ for sustainable development

It is well understood that achieving the SDGs globally – and at a national level – requires the mobilization of domestic and international private financing as a complement to public-sector resources. In fact, as with all development goals, finance is the linchpin without which progress cannot be made, and mobilization of all types and sources of capital is fundamental to complement the necessary but not sufficient provision of scaled-up public funding commitments. The value of blending these various sources together for greater impact is increasingly well understood, but practical solutions to scale up SDG financing remain nascent – including issues around standardization for investors, approaches to scaling up financing such as asset securitization by development finance institutions (DFIs) and multilateral development banks (MDBs), development financing platforms, and capacity building throughout the ecosystem of stakeholders, including governments, policy-makers, DFIs/MDBs and other financial actors. The Global Future Council (GFC) seeks to advance effective actions that can be taken by recipient countries and supporting institutions to bolster the acceleration of SDG-related investments.

> The **Global Future Council (GFC) on Development Finance** is comprised of experts with extensive experience on topics relevant to development finance, including members that bring perspectives from across the investment community (public, private and development finance). The GFC on Development Finance is one of 38 councils convened by the World Economic Forum that focus on topics dedicated to promoting innovative thinking in order to shape a sustainable and inclusive future for all. GFC members advise on a vision for progress in their area of expertise and provide recommendations on how to achieve it.

The landscape of finance has changed: It is clear that the full range of development finance flows will need to be mobilized for the funding, financing and “crowding in” of capital for sustainable development objectives, in addition to the essential continued progress towards meeting longstanding official development assistance (ODA) commitments. There are numerous development finance institutions (multilateral, bilateral and national) around the world, each with specific mandates to accelerate sustainable development, but not always with the same emphasis on each of the various SDGs. In large part, they are well positioned to help fill financing gaps associated with meeting the SDGs, even if there is room for progress in terms of the skill sets and tools they deploy.

The basic principles of “engaging” and “catalysing” the private sector are broadly understood across most development finance institutions, including all of the multilateral and most bilateral development finance institutions;[2] however, there remain significant gaps when it comes to implementation. This is, in part, due to existing challenges in many countries in the business-enabling environment, which increase investor risk perceptions. Many of these institutions have been at the leading edge of what is now commonly referred to as blended finance, which embodies the practices of using public funding to address investor risk perceptions and drawing on private capital to achieve impacts and returns.[3] Blended finance has been promoted as an important approach to achieving development impacts, in particular for those investments where concessional and/or patient public capital can functionally fill the financing gap (either through actual financing, appropriate risk sharing or guarantees) to enable private capital to invest. In particular, the work of Convergence, GAVI, Global Fund, Danish Climate Fund, Danish SDG Fund and others has employed innovative structuring approaches to help catalyse private capital for investments in more challenging countries, addressing investor risk perceptions through structuring, or advisory and capacity support. More broadly, DFIs have worked upstream to enhance policy frameworks and capital markets as key underpinnings of finance mobilization efforts undertaken with tools such as blended finance.

Notwithstanding the body of experiences among many development banks and SDG-specialized funds and programmes, the practice – or mechanics – of blending public capital to leverage and "crowd in" private capital remains largely uncultivated. Many governments and policy-makers remain unfamiliar with the role and function of tools such as blended finance – to the extent that some client countries and development finance partners remain focused on an incomplete "funding" paradigm for development, based on (mostly public) flows relying significantly on ODA. This prevents a more holistic consideration of "financing" development through the mobilization of a range of public, private, domestic and international financing sources to build and implement a high-impact pipeline of projects, programmes, policy and market reforms that will meaningfully advance national SDGs.

Countries remain limited in their ability to move from a funding to a financing approach due to capacity constraints and incomplete deployment of tools or support mechanisms. They are not fully able to field a pipeline of projects that both contribute to a country's sustainable development objectives and are suitable for private financing. As financing is the ultimate result of well-prepared projects, a lack of projects is a critical challenge of moving from a funding paradigm, wherein countries simply ask for more development aid, to a financing paradigm, where countries strategically use their existing funds for interventions and projects that can create the right environments to attract private investment. Greater appreciation at the country level of the parameters for mobilizing private finance, and the mechanics of blending public capital to leverage private capital, could therefore lead to better-prepared projects from governments and other national stakeholders and help to mobilize the right types of financing. Failure to support the ability of governments and policy-makers, and subsequently development finance institutions, to be more efficient and strategic in their allocation of development finance impacts their ability to effectively crowd-in private capital where feasible. New and innovative approaches to the supply of development finance and improving the conditions to increase demand for finance thorough upstream policy work and technical assistance, as referenced in the G20 Eminent Persons Group report on Global Financial Governance (i.e. country platforms), could dramatically increase the pipeline of investable opportunities.[4]

The **purpose of this paper** is, therefore, to help the Global Future Council on Development Finance define its 2019 agenda related to guiding countries and institutions in making the **shift from a development "funding" model to a "financing" model.** This paper attempts to review the challenges and barriers that prevent countries from thinking about mobilizing capital for sustainable development – including their own domestic budgets, domestic private capital, international donor/aid budgets and international private capital – in the most efficient and effective ways. It reviews specific challenges that currently exist in the provision of support and the mobilization of financing by development finance partners and maps some current efforts to address those challenges. In doing so, it outlines opportunities for action to improve how the development finance community cooperates in support of country efforts to strategically and efficiently tap into all relevant flows of public and private finance to achieve the SDGs.

A. Country-led approaches to marshal finance for the implementation of the Sustainable Development Goals

Driving funding to finance national SDGs will require efforts to address a number of barriers and gaps, some of them financial in nature, but many of them systemic (e.g. legal, regulatory and enabling environments) and behavioural (e.g. capacity and skills among key stakeholders at all levels). Each of these are, of course, interlinked and interdependent and can affect a country's ability to achieve its national SDGs.

While significant progress has been made on issues that address barriers and gaps that are financial in nature, less has been done to address both systemic and behavioural barriers and gaps that impede sustainable financing across all SDGs. In this respect, two constituencies play critical roles in moving from a "funding" to a "financing" approach to mobilize financial sources for sustainable development, as they hold the key policy and public finance levers that will guide, mobilize and sometimes directly fund private investment allocations by the private sector:

1. **Country-level policy-makers**, and institutions such as National Development Banks, involved in developing and implementing country-driven sustainable development policies, plans, projects and programmes

2. **The development finance community**, including multilateral and bilateral DFIs, specialized SDG-related funds and programmes, and in some cases philanthropic funders

Both of these will want to effectively engage a third key constituency, namely domestic and international actors from the private sector, including those from the financial sector, with a view to understanding respective capacities, access to commercial finance, and risk appetites (other key constituencies include community stakeholders, local and regional governments, etc.)

Efforts at the country level

At the country level, it is often posited that successful realization of the SDGs will require:

1. Mainstreaming a country's specific SDG-related goals into its national policies, plans and strategies

2. Ensuring through this process that there is a proper analysis of the enabling environment, institutional mechanisms and systems to track achievements against these goals

3. (Perhaps most importantly) linking these goals with the development of a pipeline of projects, programmes and policy interventions that are aligned with, and can facilitate, the achievement of the country's SDGs

Approaches such as "integrated national development strategies and financing frameworks", "sectoral sustainable development strategies" and "SDG implementation plans" should underpin all efforts to mobilize financing for the SDGs, but progress is not uniform across countries. Developing countries regularly call for more support to help them build the necessary capacity and institutions to achieve such efforts – the "means of implementation" insisted upon for the implementation of various sustainable development-related international conventions. Since the SDGs and the Paris Climate Agreement were announced in 2015, many countries have begun to undertake country-level assessments and plans that are aligned with broad sustainable development objectives as well as each country's climate commitments.[5] In some countries, these nationally determined contribution (NDC) processes have already had very practical outcomes in that they have served to advance the profile of climate change in national political agendas. In some cases, countries have enhanced their institutional structures for dealing with climate change, setting up new inter-ministerial committees, appointing climate-change focal points and central ministries, and improving overall communications on areas related to the NDCs (e.g. finance, energy, disaster reduction) between ministries. However, efforts to systematically attract private finance in support of the NDCs remain nascent.

The Paris Agreement as a model for country-driven planning: 2015 was a historic year – 196 parties came together under the Paris Agreement to transform their development trajectories and set the world on a course towards sustainable development, aiming at limiting warming to 1.5°C to 2.0 above pre-industrial levels. Through the Paris Agreement, parties also agreed to a long-term goal for adaptation – to increase the ability to adapt to the adverse impacts of climate change and promote climate resilience and low greenhouse gas emissions development in a manner that does not threaten food production.

Nationally Determined Contributions (NDCs) are at the heart of the Paris Agreement and the achievement of these long-term goals. NDCs embody efforts by each country to reduce national emissions and adapt to the impacts of climate change. Embedded within the agreement (Article 4) is the requirement for each party to prepare, communicate and maintain successive NDCs that it intends to achieve.

Source: UNFCCC, https://unfccc.int/process/the-paris-agreement/nationally-determined-contributions/ndc-registry

For the broader SDG goals, this type of integrated approach through government institutions varies by SDG objective. In some cases, governments have established SDG coordinator(s) within certain ministries; however, for many SDGs, achieving the goals requires concerted efforts at local and state levels. As a result, national involvement (particularly with regard to upstream coordination with international policy-makers and funders) is a necessary but not sufficient element of successful SDG achievement. Furthermore, as with the NDCs, where country strategies exist around the development goal, they are often high level: in many cases, these lack a well-articulated pipeline of projects or investments to achieve those goals.[6]

Efforts and progress by the development finance community

The landscape of development finance has changed significantly over the past two decades. In particular, the development finance community has made significant progress addressing barriers that prevent financing of important development priorities, including those embodied by the SDGs. Several SDG-specific investing approaches have been developed that highlight the opportunity set for private investors, and provide solutions which can "crowd in" capital from a variety of sources targeted for investments supporting a specific SDG goal (e.g. SDG 5 Gender Equality, SDG 7 Energy Access).[7] Perhaps the most significant advancement towards a development finance community that can help drive funding to finance a country's national Sustainable Development goals has been the progress and advancements made on the topic and practice of blended finance. These specifically seek to employ scarce public resources (international and domestic) to stimulate private investments where the potential for long-term (commercial) sustainability exists and where such blending can allow for effective risk sharing and demonstration to enable projects to happen that might not otherwise.[8] As an important activity of many DFIs, blended finance also helps to exploit their unique set of financial and non-financial tools, which can be applied to help investors overcome risks (both real and perceived) and other barriers for investment, across various stages of a project's maturity.[9] Furthermore, the development finance community has made significant strides in evolving approaches, initiatives and platforms that address important barriers and challenges at various points along the project life cycle in order to mobilize private capital towards development goals. The evolution of blended finance approaches has thus opened up a new way for countries to finance SDGs.

Blended finance practice: Model to encourage private capital

The Sustainable Development Investment Partnership (SDIP) and the Blended Finance Task Force (BFTF) have undertaken significant work to describe how the blended finance approach can be applied to address common barriers for private capital to invest along important stages of the project life cycle – including from early conception through more advanced mature approaches to "crowd in" private capital, such as through fund and aggregation vehicles. This work delineates market segments along the project life cycle based on maturity of the company/market. It outlines the types of capital needed by projects and enterprises at various stages of the investment or project life cycle, and the role that development finance plays to help investors overcome the barriers that exist at various stages. A full explanation of this approach can be found in ***Annex B***.

In addition, the Development Finance Institutions (DFI) Blended Concessional Finance Working Group has shared best practice and developed standards for the special case of blending concessional (below-market) finance with commercial finance to support pioneering private-sector projects in high-risk settings. A set of "DFI Enhanced Principles" provide guidance to ensure concessional funds are used where required for high-impact projects, are used efficiently with a clear path towards sector financial sustainability, use a variety of tools (such as advisory services) to help create markets, and use high environmental, social and governance standards. The DFI working group recommends that for effective and efficient use of precious public funds, implementers of blended concessional finance adopt these principles and providers of concessional finance (donors and foundations) require their application to avoid market distortions and build trust among stakeholders that concessional funds are being used responsibly.

Notwithstanding the efforts happening at a national level, and the significant advancements over the past two decades by the development finance community to use blended finance approaches to catalyse private capital financing and investment, **one of the most significant challenges that remains is that of pipeline and origination**. Specifically, progress has been slow on building pipelines of projects that: (1) support a country's sustainable development goals while also being (2) well-structured and (3) bankable (or having the potential to be bankable). Scale – either in terms of numbers of projects that contribute to a country's SDGs or volume of finance – will be challenging in the absence of addressing the pipeline challenge. Much of this work needs to happen at a national level and will be an absolutely critical part of creating the systematic "transformation" required to fully realize the SDGs.

B. Connecting country-level Sustainable Development Goals and private capital

Strategic policy planning for sustainable development financing

Governments are best placed to link efforts to mobilize financing with national sustainable development priorities. These should include efforts to build project pipelines and ensure that country planning processes enable more strategic thinking about how to allocate public capital in a way that encourage private capital to invest in projects across sectors.[10] The principles of "engaging the private sector" are broadly understood by governments; however, the mechanics of how to do so at each step of the country planning and project cycle, with a view to identifying and financing a pipeline of relevant projects, are not. **This is fundamentally both a capacity/skill set gap and a behavioural gap.**

Strengthening SDG country planning will require both (1) enabling decision-makers to develop well- articulated projects and programmes that support high-level country goals; and (2) addressing the capacity gaps within those governments and national institutions that are vital for the operationalization of effective country planning processes.

In the absence of central ministry coordination, it may be challenging for countries to come up with a single comprehensive SDG plan that encompasses all sectors. Regardless, country SDG planning processes should incorporate sector-based approaches given the differing nature of stakeholders and sources of capital involved.

In order for countries to move from a funding paradigm to a financing paradigm, there is a clear need for countries to begin thinking about linking their country-level SDG goals with a "national allocation process", which includes a strategic financing approach that can (where possible) mobilize private capital.

Enabling countries to think differently about capital, and shifting to a "financing" paradigm, will require the following four elements:

Element 1: National sustainable development priorities and plans: In most cases, sustainable development priorities are set by national governments through a variety of means, including through the strategies developed to contribute to global commitments (e.g. the NDC process) and through sector strategies and programmes with various ministries. If governments are the drivers of the prioritization and achievement of goals within a country's sustainable development agenda, they also have a vital role to play in: (1) articulating a pipeline of projects that support those plans; and (2) driving funding to finance national sustainable development priorities. The United Nations VNR process provides one mechanism for countries to assess their progress against their SDG implementation goals and identify new opportunities to finance their projects.

Element 2: A well-articulated pipeline of projects: As previously discussed, national efforts to translate a country's sustainable development priorities into a well-articulated pipeline of projects that enable a country to achieve those priorities remain perhaps the most significant gap that exists at the country level. The Paris Agreement NDCs are an example of a process under which countries and donors have invested significant efforts to develop country-driven strategies that help meet (some of the) SDGs but have not yet produced, in many cases, a well-articulated pipeline of projects.

Element 3: A national allocation process linked with SDGs: Taken collectively, a country's development priorities across all sectors – including infrastructure, health, education and poverty reduction – are likely to require more financing than a country's available public capital can support, inclusive of capital provided to public budgets from international aid and development institutions. Countries must think strategically about how to allocate their own public resources, how to allot international public resources (e.g. from development finance), and how to tap into and/or mobilize both domestic and international private capital.

One important aspect is the need to ensure coordination not only across government agencies, but also with relevant stakeholders important for delivering on a country's SDG goals, including: private-sector businesses, private finance and other development partners. The role of the private sector cannot be overestimated. Many can argue that the role of government policy is to build prosperity, promote economic development, alleviate poverty and ensure dignity for all communities. These factors are also in the self-interest of the private sector, which can be instrumental in enabling sustainable development that contributes to these objectives. But the private sector will need to do so with inherent return profiles that themselves enable sustainability, produce jobs and allow for growth.

Engagement across all stakeholders – governments, development partners, finance and private sector – will help to identify and classify project pipelines into investment types that are ready, close to ready, need policy tweaks or other support, and are not likely to gain private-sector support. This can inform where and how to use scarce public resources to fund their priorities, and where to use these resources (through blended finance approaches) to mobilize private capital.

Element 4: Creation of a national "strategic financing plan" for SDGs: The creation of "strategic financing plans" for SDGs, which enable effective, efficient use of public capital (domestic and international) as well as strategies to mobilize private capital (where applicable) will be critical to help countries finance their SDGs. If a country has undertaken: (1) the strategic assessment of its sustainable development needs and the pipeline to achieve those goals; and (2) a strategic allocation and financing strategy for funding those goals, it will be better prepared to engage with sources of funding and financing. These include development finance, concessional and/or patient sources of capital, grant sources necessary for building the enabling environment and country systems and, of course, commercially oriented private capital. As part of the strategic allocation process linked with SDGs, countries should have a more focused understanding of where to use various financing approaches. Doing so will enable them to move from a funding model to a financing model.

Country Private-Sector Diagnostics (CPSDs)

The Country Private-Sector Diagnostics (CPSDs) are jointly produced by IFC and the World Bank. This is a tool introduced to enable IFC and the World Bank to more systematically identify opportunities to help create or expand markets and private-sector investment in developing countries. The diagnostics tool helps identify opportunities and the barriers that need to be overcome to create markets in some of the most challenging areas of the world. The tool highlights areas where private-sector investment could have significant development impact through improvements in efficiency, services, job creation and sector growth. These reports tap into IFC's knowledge of the private sector and its needs and challenges, and the World Bank's expertise in promoting country policy reforms and dialogue with governments. Each publication includes an assessment of the state of private-sector development in the country, a review of the macroeconomic situation, and the relevant policy constraints. It also indicates the opportunities for and constraints on increasing private-sector investment and growth in key sectors that impact economic development.

Efficient allocation of public funds and international support to mobilize private capital for sustainable development

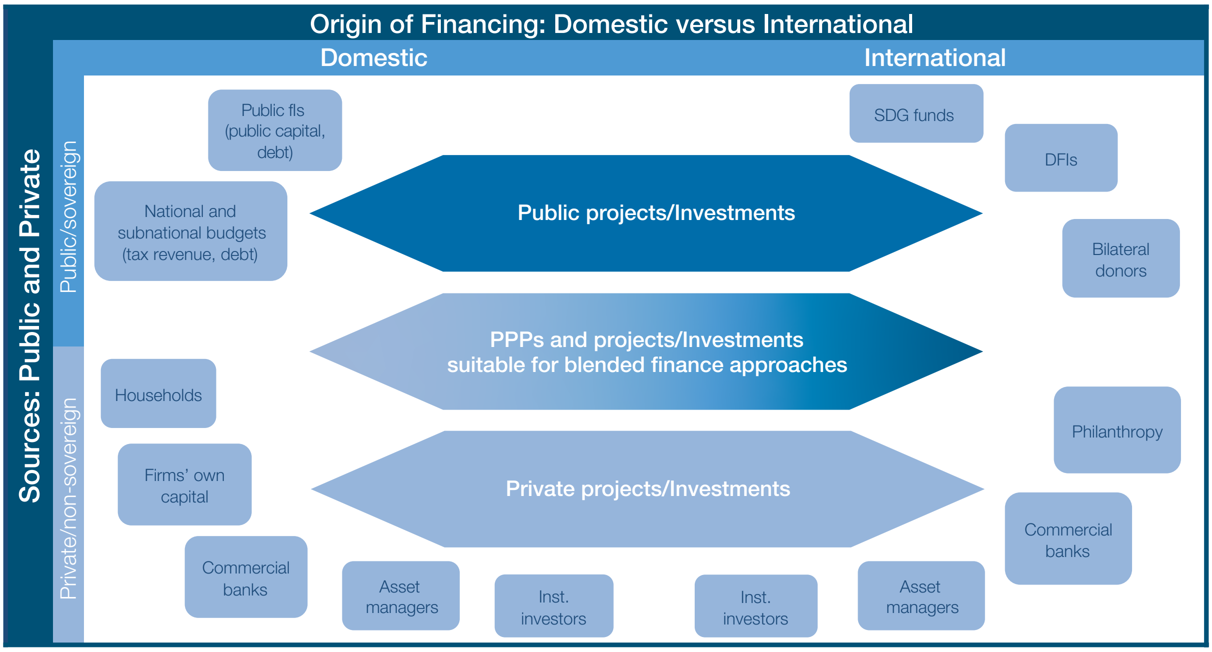
As mentioned above, not all projects, programmes or approaches that contribute to the SDGs will have inherent return profiles that can attract private capital, and many may not have the potential for such return profiles. Thus, the ability of governments to engage private capital in investments along all SDG areas will vary. But countries have – through their country planning processes, and through the application of international public/ODA financing – the ability to more effectively and efficiently allocate their public dollars to mobilize private capital for sustainable development so they are both: (1) using their public finances where they are most needed; and (2) maximizing the potential to stimulate private investment (both domestic and international).

Improving country allocation processes first requires an understanding of the various sources of capital, how they can be used (including along the project cycle, from early-stage through to more mature approaches, such as through funds and aggregation vehicles, as well as capital markets). In general, funding sources can be categorized as:

- **Domestic public sources**, including tax revenues and national budgets, subnational budgets, domestic public financial institutions, public pension funds
- **Domestic private sources**, including local banks, local equity and venture capital (VC) investors, firms and small to medium-sized enterprises (SMEs) balance-sheet financing, consumer savings and households
- **International public sources**, including development finance institutions, bilateral donors, some sovereign wealth funds (SWFs) and (for SDGs) SDG funds
- **International private sources**, including commercial and investment banks, institutional investors/pension funds, insurance companies, asset managers, equity and venture capital investors, philanthropy, high-net-worth individuals

Each of these sources has varying levels of risk appetites, and not all are appropriate to finance (fund) projects at all stages of development or maturity. Therefore, approaches to mobilize or "blend" these sources require a thorough understanding of the financing needs and risks of projects at different stages. The Sustainable Development Investment Partnership (SDIP), through its Redesigning Development Finance Initiative (RDFI), and the Blended Finance Task Force (BFTF) have also developed paradigms and a toolkit that is a helpful guide on how to think about the roles and function of specific types of funding sources as applied along various stages of the project cycle. These include: (1) preparing; (2) pioneering; (3) facilitating; (4) anchoring; and (5) transitioning.

Figure 1: Types of capital available for countries to meet funding needs



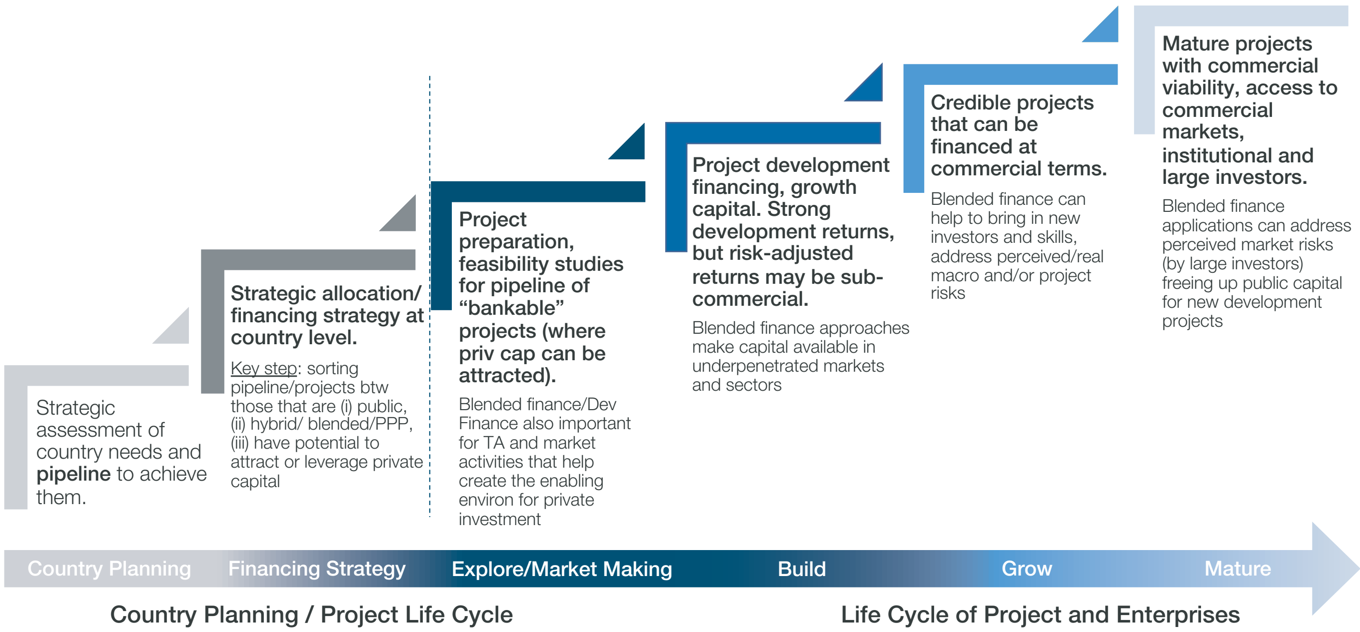
The figure illustrates how different countries may view various sources of financing to support their SDG goals, including public and private, domestic and international.

- **Quadrants of capital: top left** – domestic public; **bottom left** – domestic private; **top right** – international public; **bottom right** – international private
- Some projects/investments will require primarily public funding; some are suitable for public-private partnerships (PPPs) or blended finance approaches, and some will be fully financeable from private sources.
- In addition to direct budgetary allocations to projects, programmes and investments, the allocation of domestic public funds also needs to provide for significant personnel costs, for example staff time of relevant officials involved in policy design, project development, fund allocation and monitoring. The availability of skilled personnel will be a vital factor for effective allocation at scale.
- Countries will need to spend significant efforts and resources to identify and characterize a pipeline of projects, programmes and investments to be financed, and to determine how much they can rely on private sources to participate.

Integrating country planning into the project life cycle to enable a strategic financing approach

Thinking strategically about allocating public money is a critical component of the "country-driven" planning process for its sustainable development objectives. From a country's perspective, this will likely form part of the upstream planning activities of the "project life cycle", which includes the identification of a pipeline of projects that supports a country's sustainable development objectives, an approach to allocating both domestic public and international public sources of capital, and a financing strategy to encourage private investment (both international and domestic), including the judicious use of concessional sources to "crowd in" private finance.[11] Figure 2 below illustrates these steps as they relate to the blended finance project life cycle, with the addition of two important steps: (1) the strategic assessment of a country's sustainable development needs, and the pipeline to achieve them; and (2) the strategic allocation and/or financing strategy for those projects, inclusive of an understanding of which projects might benefit from the blended finance approach, and which may not be suitable.[12]

Figure 2: Country planning process linkages with life cycle of projects and enterprises



A strategic approach to financing country plans

The allocation of public budgets and the selection of projects for which sources of capital beyond public budgets will be sought should be an inherent part of the country planning process for its Sustainable Development Goals. The country planning process should include both:

1. The identification of a pipeline of projects and interventions that will help a country achieve its SDGs

2. A deliberate thought process around that pipeline to determine that projects have the potential to attract international and/or domestic private capital (in the first instance), which ones may require a blended finance approach, whereby development and soft capital can "crowd in" private capital by sharing or reducing risks, and which projects are by their very nature purely publicly financed

This approach should include not simply the financing strategy for a pipeline of investments, but must also be grounded in an understanding that a healthy policy and regulatory framework which is attractive for investors of all types remains critical for the financing of SDG goals in any country. The requirements for developing or enhancing the enabling environment include regulatory, legal and policy reforms, building capacity across public-sector and local private-sector stakeholders, and support for establishing or deepening local financial markets and institutions. Each of these can contribute to reducing the real and perceived risks to private finance, and can increase the viability of projects that attract those sources of capital (both domestic and international). Furthermore, in the interim, the strategic application of blended finance can complement, rather than substitute, and help to accelerate these investments more quickly than may have happened otherwise.

"Investable governance" at a country level

While moving from a funding model to a financing model for sustainable development necessarily requires building capacity for policy-makers to understand how to think about allocating the sources of capital they may access, parallel efforts are also needed that can enhance complementary policy frameworks. These can help attract capital (both international and domestic), build investor confidence and enhance the overall business-enabling environment. Often these activities include non-investment activities, for instance improving governance mechanisms – such as the important legal and regulatory landscapes for building a healthy private sector. Investing the time and effort to improve these governance mechanisms is critical for the long-term success of mobilizing capital: not only the private capital that can help finance a country's SDGs goals, but also public sources of capital such as development aid, which can be more efficient and effective in terms of allocation.

Figure 3: Country planning

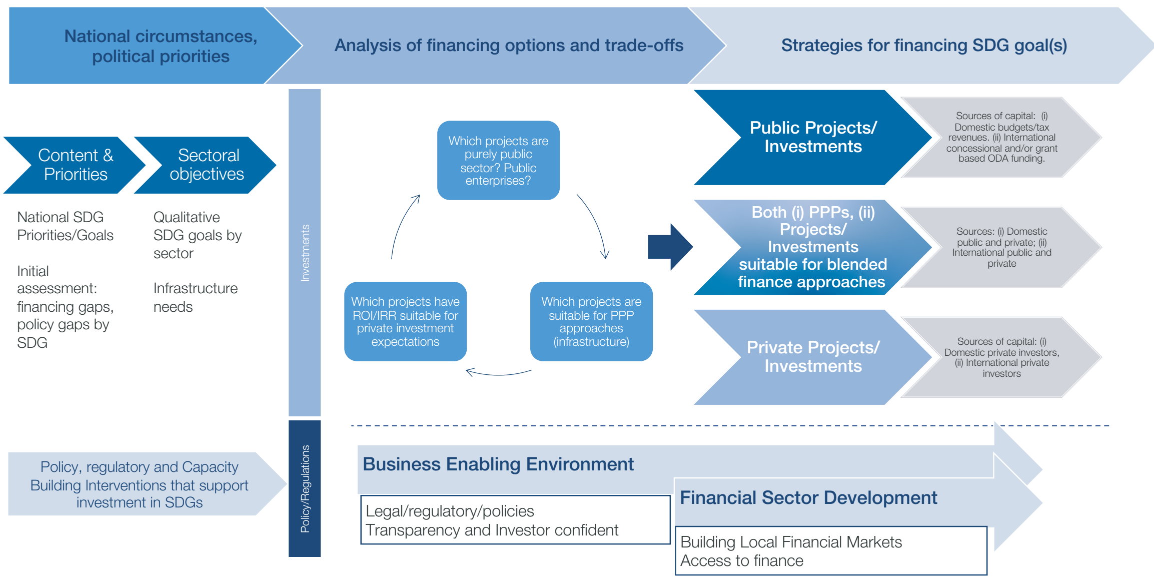


Figure 3 illustrates the process of moving through a country planning process that anticipates: (1) the articulation of a country's national SDG priorities and goals, and sectoral objectives; (2) the analysis of financing options and trade-offs, including a specific approach to strategically allocating public dollars; and then (3) the creation of strategies for financing SDG goals that clearly align with the types and sources of capital that can be mobilized. Analysis of financing options requires a decision-making process that can support the strategic allocation of public capital. Annex C provides further explanation of an illustrative approach to this type of decision-making process in terms of the strategic allocation of public capital, and a financing strategy more aligned with mobilizing private capital.

C. Where are the gaps?

Clearly, significant strides have been made since the launch of the Millennium Development Goals in 2000 in regards to efforts to close the financing gap for development. Countries have stepped up their efforts to develop country-driven strategies that help them meet global goals, such as those in the Paris Agreement and the SDGs, while taking into account their varying levels and stages of development. DFIs have made marked progress in the area of blended finance and have proven its usefulness in mobilizing private sources of capital (both international and domestic) for investments that have high impacts, and have delivered significant support for policy improvements and market development. However, gaps still remain that prevent both the scaling up of finance to address the consistent shortfall in meeting investment needs and the more fundamentally transformational and systemic changes required to underpin sustainable development in the long run.

Building blocks of good overall development

Several elements form important "building blocks" of good development; addressing each of these is needed to ensure a successful approach to financing the implementation of SDGs at the national level. These building blocks can also represent areas of potential improvement in both: (1) the way countries approach financing their SDG goals at the national level; and (2) how SDGs are supported by DFIs:

– **An inclusive and effective development financing model** is needed. It should consider both public and private capital and the need to develop public infrastructure and the local private sector (enterprises, SMEs, etc.), as well as the local financial system and markets, as each is integral for building sustainable economies. Furthermore, development also requires efforts to improve the legal, regulatory, policy and enabling environments to fully realize a country's sustainable development objectives. This should be performed in an evidence-based way, relying on current and historical data, in particular related to the ability of the private sector to support sustainable development investments across the spectrum. Important questions include: Are the interventions pursued with respect to implementing SDGs grounded in an appropriate "theory of change" that adequately considers both public and private sectors, as well as public and private financing approaches, including their differentiated risk appetites? Are these interventions grounded in current experience, lessons learned and backed up with data? Do the interventions appropriately ensure private-sector engagement in the implementation of the SDGs – whether in addressing the role of the private sector in producing effects that need to be managed, providing services or acting as the primary investor in, and financier of, sustainable business models? Do they focus on financial leverage as a goal in and of itself, or as part of a broader framework for transformation through mobilization?

– **Institutions and tools** from the development finance community locally can be used to achieve impacts locally but they need to be deployed strategically to maximize the effectiveness of public capital and achieve mobilization at scale of private capital. Development finance has developed a suite of approaches (including blended finance), financing instruments and facilities through international cooperation. As such, it has shared lessons and experiences with a view to building consistent frameworks, principles and practices. Some questions include: Despite progress, are available tools – such as guarantees and risk-sharing mechanisms – efficiently deployed in different national and market circumstances? Can they be sufficiently scaled up to meet the investment gaps? Do the providers of these tools (e.g. MDBs) assume a sufficient amount of risk to encourage other investments? What is the role of new development institutions in the broader development finance ecosystem, particularly domestic development finance institutions that may be better situated to understanding local market risks, and thus may be best placed to provide effective risk sharing? Are development institutions complementing and cooperating effectively to maximize their impact through financing – including by pooling resources or by creating joint financing vehicles that allow for scale to be achieved with scarce donor funds, or by attracting private capital to them?

– **Capacity and skills** at the national level and within DFIs need to be in place in order for countries to best maximize their scarce public resources and catalyse investment from across a range of financing sources. In particular, detailed work has to be done to break down country strategies into tangible actions, and to further understand: (1) the financing gaps that exist within those sustainable development activities; (2) the potential of those activities to attract private investment; and (3) the range of tools and options a country can use to incentivize those investments. Some important questions include: Do governments have the capacity to design holistic plans that are well designed, including well-articulated pipelines of projects? Do governments have the capacity (skills and people) to implement SDG plans and policies? Do relevant authorities and institutions such as National Development Banks have the mandate or authorizing environment to fulfil their respective roles in blended finance approaches along the project cycle (which may outlast political cycles)? Do national private financial actors have the capacity to evaluate, manage and underwrite SDG risks? Do development finance institutions have people with the right skill sets to support country-level allocation processes, the development of financing strategies and blended finance approaches? Do DFIs have the capacity to take on more risk?

- **Behaviour**: Even when the capacity exists to help undertake detailed work to break down countries' strategies into a pipeline of public and private investments, challenges often exist within governments that impede effective decision-making on development objectives. These include the behaviour of national officials who often have a stated or revealed preference for international public support in the form of direct grants or concessional loans, or who simply do not have the skills or capacity within their ministries to think more strategically about how to leverage public capital to attract private capital. This also relates to national private-sector actors that seek to benefit from grants or concessional finance provided by public funds; national actors in both the public and private sectors looking to protect vested interests; international public funders that may be competing with other funders and the private sector for scarce project opportunities; and international private financers who may overestimate risk in frontier markets and technologies. Important questions include: What is the best way to influence and achieve "behavioural change" among government or national officials in order to enable a better country allocation process for SDGs?

- **Measurement** of ODA flows, mobilized finance and impacts across SDGs is critical as part of a broader effort to better measure SDG achievement at the national level. However, challenges exist in assessing impact/aid effectiveness for some recent mobilization approaches, including lack of clarity in how both direct mobilization and co-financing are measured (e.g counting MDB commercial financing together with private mobilized finance) and measurement of longer-term transformation of sectors and markets, which may result in a more ambiguous picture of the impacts of development and aid financing. The efforts of the OECD to develop a reliable measure of Total Official Support for Sustainable Development (TOSSD) is intended to help tackle this challenge, but may take years to be defined and consistently applied. Meanwhile, the MDBs have developed a methodology to facilitate joint reporting on private capital mobilization rates that provide at least some visibility on private capital flows that are being facilitated.[13]

This paper focuses the analysis on the first three factors, namely: (1) the inclusive and effective development financing model; (2) institutions and tools; and (3) capacity and skills. In part this is because there is currently ongoing work around the issue of measurement and metrics for SDGs. Thus, influencing behavioural changes may be more challenging, and (in the best-case scenario) will likely result from efforts to address gaps in capacity and tools. We therefore consider three important questions:

- **Question 1**: Have efforts to date at the national level and within DFIs been comprehensive and targeted to a degree that impacts can be achieved to effectively finance a country's SDG goals?

- **Question 2**: Have the right tools been deployed?

- **Question 3**: Are the right skills/capacities available at the national and institutional level throughout the SDG financing system to implement the right tools underpinned by a robust theory of change?

Question 1: Are our efforts to finance sustainable development comprehensive and targeted where impacts can be most significant?

Much of the activity of both the development finance community and countries related to filling the financing gaps to meet sustainable development goals has been disproportionately focused on blended finance transactions and project-level mobilization, and not enough on country planning efforts, capacity and pipeline development or impacts. Three key "theory of change" flaws have been highlighted in recent published work, including:

- **Underestimating the importance of national capacity to undertake a strategic allocation of scarce public resources, to mobilize private capital (in particular, both domestic and international sources) and the effort required to build that capacity**: Beyond the project pipeline, demand-side drivers overall may be under-considered in efforts to drive financing towards SDG implementation. For example, there is a growing understanding that policy drivers for green infrastructure demand are critical to efforts of countries such as China to shift towards a more sustainable economy;[14] and that establishing them requires competent authorities with skills in addition to the resources to develop, design, implement and enforce them, including implementing fiscal and other incentives. Despite this, efforts to mobilize finance are often divorced from national policy contexts, focusing on transactions and deal flow without considering either how well-selected transactions can underpin and multiply the impact of specific national policies or the support and technical capacity building needed to develop and strengthen policy environments in parallel to (or prior to) deal making. Messages along these lines are coming from countries undertaking Voluntary National Reviews of their progress on SDGs[15] as well as in institutions such as the Green Climate Fund.

– **Not enough focus on generating project pipeline**: There is a lot of capital chasing too few projects.[16] While a major focus in donor capital and funding agencies has long been on getting real impacts locally through project-level finance, not enough attention has been paid to building a pipeline of projects that can be commercially viable, including support for early-stage companies, companies in growth stage or projects that can scale development impacts. Project development activities, including capacity building for these types of companies, are important to generate quality projects at the recipient country level. This takes time and significant resources – well beyond those generally made available for readiness, concept development and project preparation at DFIs and in SDG-dedicated funds and programmes such as the World Bank Group's "Maximizing Finance for Development", which systematically leverage all sources of finance, expertise and solutions to support developing countries' sustainable growth.

– **Overemphasis on transactions and transaction-level impacts such as leverage instead of market-level transformation by creating enabling conditions and broad mobilization through risk-taking**: The excessive focus on transactions over creating markets by focusing on policies that can multiply the depth of pipelines is only one aspect of an over-reliance on narrowly scoped projects (many of which use blended finance approaches) without considering whether their market-level impacts are well targeted. To use the climate change financing world as an example, much effort is being made to deploy hard-currency concessional loans as a way to unlock large-scale infrastructure projects and to encourage the mobilization of funds through securities such as green bonds. These are not necessarily damaging actions – they can lead to large emissions reductions or improvements in resilience of large populations. However, given the limited availability of capital, projects may be funded that create limited opportunity costs at the expense of other, more impactful, transformative projects. They may also risk crowding out incipient local markets compared to other possible interventions (for example, financing in local currency, taking equity positions in more innovative models, etc.). Critiques about DFIs' focus on volume and institutional returns instead of impact or mobilization have been well articulated[17] and are gaining currency along with a recognition that DFIs' transaction focus needs to evolve to a more systemic, well-aligned approach.[18] It should also be noted that DFIs generally work to maximize the volume of their own transactions, rather than effectively complementing and cooperating across the DFI system – internationally and among regional and national development banks – to maximize SDG financing volume overall. DFI governance and staff performance evaluation may create perverse incentives to compete with the market and other DFIs in this respect.

Question 2: Do we have the right tools in the right places?

Development institutions are well placed to understand the risk and returns of SDG investments in emerging markets and to support investment climate reforms that can reduce risks faced by the private sector. However, they may not be addressing, in a comprehensive way, the complementary efforts required to support the linkages between the country planning process and a pipeline of investments, nor are they consistently pushing the limits of their risk taking, particularly downstream for early-stage projects.

Development institutions need to effectively balance development impact and investment sustainability and profitability, but they remain well-suited and well-positioned to operate across a range of interventions. These include project preparation through to anchoring large(r) aggregation vehicles and funds that can crowd in larger forms of private capital in a manner aligned with the SDGs, particularly where the capital base requires a certain return on capital. However, some DFIs may have conditions on their resources that prevent them from being sufficiently "risk-inclined" to adequately finance some types of projects, including where capital is not available in the appropriate local currencies. Annex B shows an illustrative mapping of initiatives, platforms or funding approaches that have been created to support the 17 SDGs.

The following gaps appear to be present throughout the tools deployed by DFIs and SDG-specific funders and programmes:

– **Underinvestment in early stages of the project cycle**: As highlighted above, national capacity and project pipelines are limiting factors that have been discounted in applied sustainable development theories of change. This has resulted in an under-provision of grants or highly flexible debt support for data and research, local knowledge, project preparation and business-model development, as well as national planning and institutional strengthening.

– **Insufficient risk-inclination to address certain market gaps**: Too often, the need to generate reflows and concerns about needing to maintain "minimum concessionality" have led to DFI finance that is barely more risk-inclined than financing coming from private sources. Financing on terms that are appropriate for anchoring and transitioning is more readily available (market- or near-market-rate debt; commercial equity) than financing on terms that are suited to pioneering or facilitating (flexible debt; junior equity). The risk-inclination of the DFIs (which is set by the shareholders and donors) may be driving the stage of blended finance deployed, rather than the project cycle driving the terms of financing provided.

– **Insufficiently addressing local currency volatility**: While part and parcel of the insufficiency of risk-inclination, the question of managing currency risk is worth highlighting. The vast majority of private-sector-oriented DFI finance is deployed in hard currency, which compounds the challenge of delivering solutions that reach local, smaller-scale actors in countries with low currency-risk management capacity – the ones who need sustainable development support the most. A further challenge is the delivery of solutions that are efficient in terms of public subsidy being embedded in financing structures that underwrite real risks rather than overcompensating for them. Local, sustainable markets can't be expected to develop properly if DFIs compete by deploying foreign-currency financing that is cheaper than the available local currency instruments.

The bottom line is that in many DFIs, MDBs and SD-related specialized institutions, there remains a significant skills and knowledge gap. This is related to understanding and addressing the language, incentives, tools and ways of viewing and pricing risk in the private sector that leads to their financing efforts not being as well targeted or additional to business-as-usual as they should be.

Question 3: Do we have the capacity where it's needed?

Both within development finance institutions, and in recipient and donor countries, the right capacity may not be in place to either: (1) think strategically about "financing" versus "funding; and (2) structure and execute the right types of financing approaches for SDG-focused investment.[19]

Effective national planning and finance deployment requires the development of a range of skills in different organizations:

In client countries, different institutions and agencies require improved capacity across the project cycle:

– **Line ministries** such as health, education, industry, energy, environment and transport need to understand how to develop a pipeline of projects to achieve the sustainable development priorities, including (perhaps critically) skills that enable them to design business models, financing and revenue models, and investment plans. They also need the capacity to evaluate their pipeline of projects to determine the suitability of various types of funding, including public (domestic and international) and the private financing potential of a project (in line with Annex C).

– **Finance and planning ministries** need to have the capacity and skills to be able to work with line ministries to prioritize projects for budgetary allocations and identify domestic private resources that could be tapped or mobilized. Finance and planning ministries have, in some cases, an important role as interlocutor with international development finance and thus need the capacity to understand blended finance approaches across all stages of the project cycle if they are to recognize where and how those funds can be applicable.

– **Ministries responsible for international cooperation** also need to understand the landscape of support and private finance, and how to engage support institutions in the financing of selected projects. They can also play an important role engaging with international development finance and export credit and trade ministries of other countries. Therefore, they need the capacity to understand the role and function of those sources of capital alongside blended finance approaches.

- **National financial institutions** need to have the skills and capacity to deploy public capital (from domestic budgets or international support sources) in nationally appropriate blended finance structures suitable to the project cycle stage of various potential investments.

- **National institutions**, whether public or private, need to improve the measurement of SDG achievement and the impact of enabling environments and financing interventions in creating the conditions for commercial SDG financing.

- **International development finance institutions** may, in some cases, need a broader range of skills to better understand the diversity of national circumstances in their client countries as well as a greater capacity to help clients undertake efforts to build pipelines and initiate a strategic allocation process, identify innovative projects and adopt and manage higher levels of risk.

While **donors** are not direct stakeholders in the national planning and allocation process in client countries, they have an important role to play in an effective transition from "funding" to "financing", beyond just providing necessary levels – and types – of assistance. This includes providing the flexibility to the development institutions they manage to take greater risks with contributed resources, encouraging greater cooperation across DFIs to avoid competition when it is harmful and establishing shared objectives and performance measurement beyond the scope of individual DFIs. They should also be willing to back innovative approaches and partnerships at greater scale. Better skills may be needed in donor governments related to appropriate theories of change, risk inclination and the management of DFIs that are moving towards financing versus funding models for development.

"Investable governance" for development finance institutions

While the importance of national policy frameworks and allocation decisions cannot be understated, "investable governance" must also be considered in terms of the support institutions working to mobilize finance to back up country efforts. Just as national governments need to set the frameworks and use allocations catalytically and strategically, DFIs governance needs to focus on strategic programming and partnerships, measuring results and ensuring value for money for both funders and recipients. It also needs to focus on making available capital with risk appetites that corresponds to key public finance and market gaps, rather than getting too involved in the development and financing of specific projects or the micro-management of operational decisions.

D. Global Future Council on Development Finance Action Agenda 2019

This overview has identified a number of gaps and barriers that prevent countries from thinking about capital – including their own domestic budgets, domestic private capital, international donor/aid budgets, and international private capital at country planning stages in support of achieving their SDG goals in the most efficient and effective ways. While financing gaps are real in many countries, additional efforts are needed to help link country-level SDG plans with national allocation processes and mobilization of private capital (where possible), and which can help move countries from a "funding" to "financing" paradigm.

The GFC can play an important role in addressing the gaps in the links between a country's sustainable development planning process, pipeline development, country allocation and financing. These suggested areas of focus for the GFC Action Agenda for 2019 are not exhaustive and seek to emphasize important activities that can build off the progress already made in areas related to mobilizing finance for the SDGs. The following are activities that could be undertaken in 2019:

GFC Action Agenda Item #1: Champion country-level capacity building

The GFC can play an important role in **creating a platform that can (i) identify the specific capacity gaps at the country level** that impede country planning, including pipeline development and an allocation process that incorporates various financing approaches for those projects suitable for private investment and **(ii) support governments in a more deliberate way to effectively undertake and apply a financing strategy for an existing pipeline of transactions**. This important research and mapping/analysis would be valuable for both countries and development finance institutions to help ensure SDG country strategies are translated into a well-articulated pipeline of projects, programmes and interventions. Towards these ends, the GFC could:

1. **Develop technical assistance/capacity-building approaches** that can help countries address these gaps, including:

    a. Approaches for countries to translate SDGs into tangible projects, programmes and interventions that help them meet those goals. These are likely to vary depending on country priorities, sectoral objectives and efforts required to create the right enabling environment to attract investments

    b. Establishing comprehensive assessment processes that countries can use to:

    - Analyse financing options and trade-offs, particularly with regards to discerning between publicly funded projects, privately funded projects and those that might benefit from a hybrid approach (e.g. PPPs or blended finance approaches), based on a good understanding of private-sector perspectives, including risk appetite
    - Create approaches that help countries develop strategies for financing their SDG goals, including effective platforms to engage various public and private sources of finance

2. **Identify (1) delivery channels and (2) funding sources** that can enable the roll-out of these types of capacity-building programmes targeted towards country-level stakeholders, as well as those stakeholders within the development finance community (e.g. MDBs/DFIs) that may be critical partners in developing financing strategies for a country's SDGs.

3. Where a pipeline of transactions exist, **help governments review their existing pipeline of transactions** for their suitability for public, private and blended capital, and help them undertake and apply a financing strategy that effectively and efficiently "finances" those transactions. The GFC could propose that more support is given to successful efforts that already exist to enable them to scale up.

GFC Action Agenda Item #2: Highlight gaps in the initiatives that support SDG plans and propose gap-filling measures and policy improvements

Notwithstanding the numerous efforts, platforms and initiatives that seek to: (1) address barriers across the project cycle; or (2) catalyse, "unlock" or otherwise mobilize financing for SDG-related investments, some important gaps still exist. This is partially because many of these initiatives simply focus on the goal of mobilizing private finance – and often only certain types of capital (e.g. institutional investors; commercial banks). There is little doubt that more effective mobilization efforts – better targeted at meeting gaps in all parts of the project life cycle – can help drive greater scale in first-round or project-level impacts as well as creating the pipeline of projects that can be attractive for other investors upstream (e.g. where markets are more mature and can attract different types of capital, such as institutional and capital markets).

Addressing financing gaps for projects at an earlier stage in the project cycle is likely to require a greater provision of grant resources and a higher upfront grant equivalent to allow for more risk-inclined investments by private capital. Greater risk taking could lead to greater returns, and efficiencies may be available in areas such as currency and political risk mitigation,[20] but filling the aforementioned gaps may require more significant risk provisioning against DFI capital and blended finance funds as well as more capital and risk reserves and an exploration of additional efforts to securitize assets.

The GFC can play an important role in drawing out the existing gaps in the tools and financing approaches as they relate to the SDGs, in particular **mapping the gaps in country-level support for SDG-related projects along all stages of the project cycle.** The following are activities that could be undertaken in 2019 with the goal of developing a toolkit to address the gaps in what is already available for countries:

1. **Benchmark different DFI governance structures, policies and practices** to identify where business model changes may be required in order to achieve greater impacts and/or highlight where partners and platforms may need to be identified and built

2. **Develop cooperative platforms** to engage DFIs and platforms in collaboration to address specific challenges in mobilization at different parts of the project cycle

3. **Examine, as needed, options for new targeted approaches/tools that can address gaps**, specifically those around underinvestment in early stages of the project cycle, insufficient risk-inclination to address certain market gaps critical for achieving country-level Sustainable Development objectives and currency risk, recognizing the need in some cases for additional resources to achieve this

In all cases, the GFC will need to continue to consider how best to engage the private sector in its advocacy and outreach, and in the development of support tools and platforms at the national and international level to ensure they are fully informed by a private-sector perspective.

In conclusion, while significant efforts have been made on issues that address barriers and gaps that are financial in nature, less has been done to address both systemic and behavioural barriers and gaps. In order to effect transformation at a scale required to meet the SDGs, more efforts are needed to address the capacity issues at the country level (and within DFIs), particularly to address challenges and barriers that prevent countries from thinking about capital – including their own domestic budgets, domestic private capital, international donor/aid budgets and international private capital – in the most efficient and effective ways to finance SDGs. The GFC on Development Finance can use the window of opportunity ahead of the United Nations General Assembly in September 2019 to develop tangible concepts, which can help fill these capacity (and knowledge) gaps, and address critical needs for countries to move from a funding paradigm to a financing paradigm.

ANNEX A: Members of the Global Future Council on Development Finance

This paper was prepared as a group product, on the basis of the recommendations emanating by the 2018–2019 Global Future Council on Development Finance, organized by the World Economic Forum. The specific views expressed are not necessarily those of all members, who may have had different opinions on some issues.

Co-Chair
Charlotte Petri Gornitzka
Deputy Executive Director,
United Nations Children's Fund (UNICEF)

Co-Chair
Gavin E.R. Wilson
Commissioner, The Business and Sustainable Development Commission

Martin Bille Hermann
Ambassador, Permanent Representative of Denmark to the United Nations

Vera Kobalia
AsiaGlobal Fellow, University of Hong Kong

Younis Haji Al Khouri Undersecretary of Finance, Ministry of Finance of the United Arab Emirates

Bridget Kustin
Research Fellow and Qualitative Lead, Oxford Ownership Project, Said Business School, University of Oxford

Bertrand Badré
Chief Executive Officer, Blue Like an Orange Sustainable Capital

Paul Lamontagne
Managing Director, FinDev Canada

Afsaneh Mashayekhi Beschloss
Founder and Chief Executive Officer, RockCreek

Elizabeth Littlefield
Senior Counsellor, Albright Stonebridge Group

Christian Deseglise
Global Co-Sponsor, Sustainable Finance; Global Head, Central Banks, HSBC Holdings Plc

Liu Yong
Chief Economist, China Development Bank

Thierry Déau
Chief Executive Officer, Meridiam

Jonathan Malagon
Minister of Housing, Cities and Territory of Colombia

Karin Finkelston
Vice-President, Partnerships, Communications and Outreach, International Finance Corporation (IFC)

Astrid Manroth
Director, Delivery and Impact, African Development Bank (AfDB)

Gargee Ghosh
Director, Development Policy and Finance, Bill & Melinda Gates Foundation

Peter Moyo
Chief Executive Officer, Old Mutual Limited

Helen Hai
Goodwill Ambassador, United Nations Industrial Development Organization (UNIDO)

Ramesh Subramaniam
Director-General, South-East Asia Department, Asian Development Bank

Mona Hammami
Senior Director, Crown Prince Court of Abu Dhabi

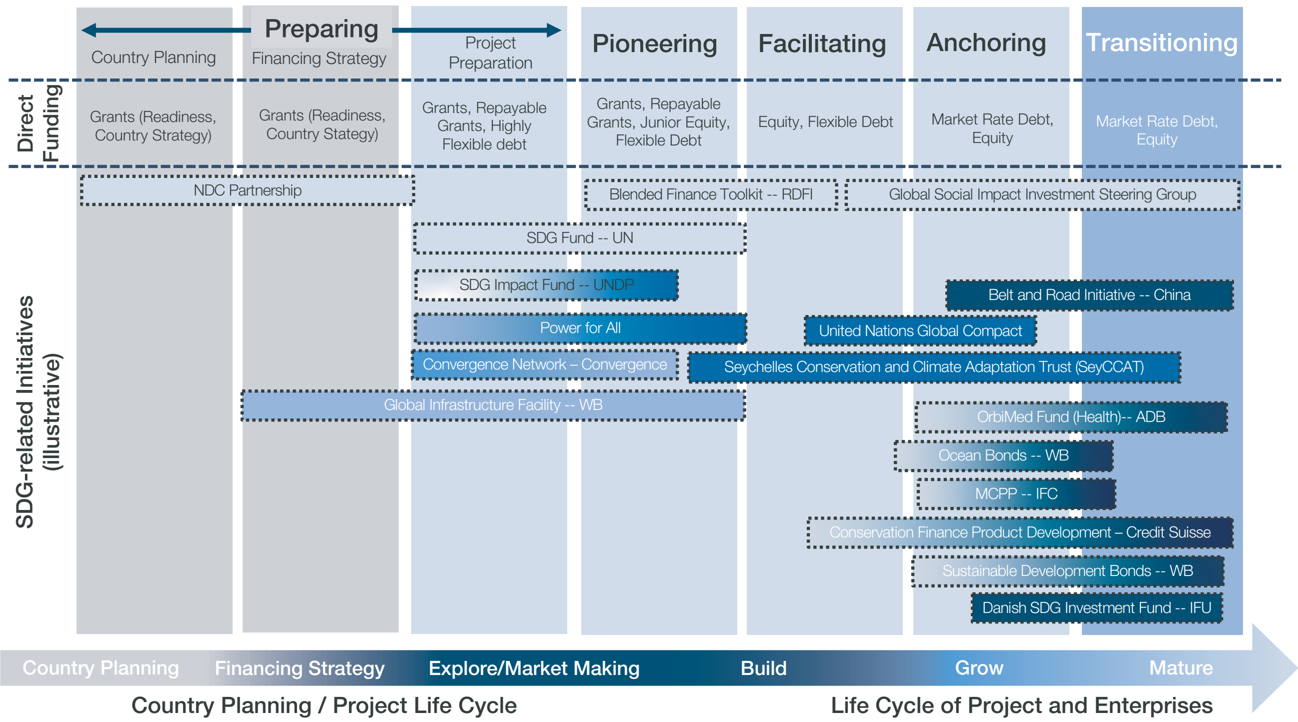
Joachim von Amsberg
Vice-President, Policy and Strategy, Asian Infrastructure Investment Bank (AIIB)

Elliot Harris
Assistant Secretary-General for Economic Development; Chief Economist, Department of Economic and Social Affairs (DESA), United Nations

ANNEX B: Illustrative mapping of SDG-related initiatives along the project cycle

Numerous initiatives, platforms and specialized funding approaches have been created to support the 17 SDGs. Development finance is already playing an important role in funding, financing and "crowding in" other capital to help a country meet its sustainable development objectives. Many of these initiatives seek to address gaps or barriers that prevent mobilization of private capital for sustainable development at specific points in the project life cycle.

Using the Sustainable Development Investment Partnership (SDIP) blended finance project cycle, the figure below shows an illustrative mapping of some SDG-specific related initiatives against the project cycle paradigm, inclusive of the upstream country planning and financing strategy parts of the life cycle, through the project-level activities (e.g. project preparation, pioneering, facilitating, anchoring), and through efforts where blended finance approaches can be applied when projects are "mature" and where aggregation vehicles and initiatives can crowd in larger, institutional or more project risk-averse types of capital. These initiatives and platforms are not exhaustive but are meant to illustrate how they target barriers and challenges for crowding in private capital for the preparation and development of projects, and through aggregation vehicles (mostly at the mature stage).



KM/Investor Awareness/Technical Assistance (Technical/Operational Expertise)	Knowledge, advisory or capacity building/training to facilitate private investment in high-impact projects and enterprises. Supports investor awareness, project level capacity and TA.
Project Preparation Grants	Funding to support the preparation of projects, including feasibility and design preparation for public, PPP and private-sector projects, structuring private capital, etc., which can facilitate private investment in high-impact projects and enterprises.
Development, Blended/Concessional Finance, Incentives	Blended finance approaches (debt, guarantees, equity) to crowd in private capital at the project level.
Commercial Approaches with Embedded Risk Underwriting (Capital Preservation)	Embedded risk/first loss structures to enable crowding in of commercial capital that fully or partially protects the investor against various forms of risk, effectively reducing their risk of capital losses.

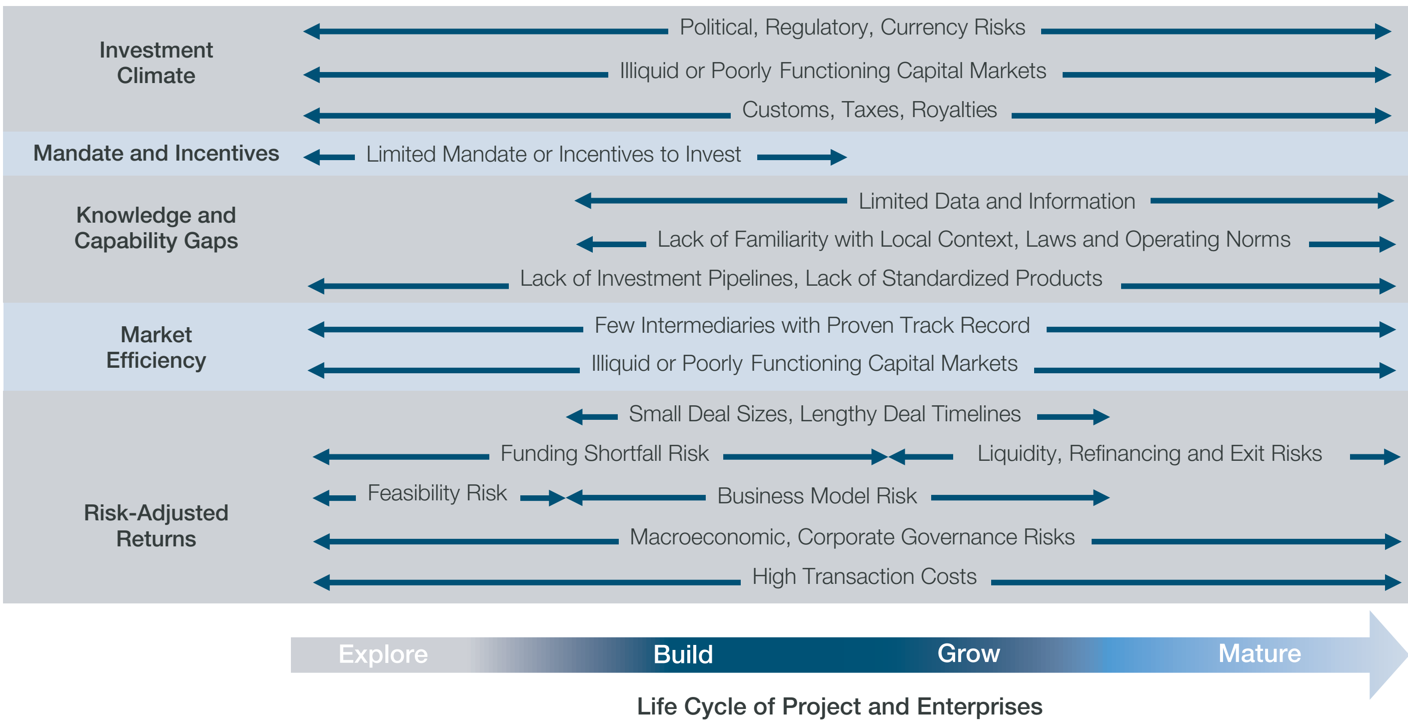
ANNEX C: Project cycle and investor barriers across stages of maturity

The blended finance "primer" recognizes that projects or enterprises at each stage of growth face a variety of challenges and require different capital contributions from investors and financiers to address the balance between risk and return. These needs and challenges mean that the financing barriers vary based on stage of maturity of an investee project or enterprise. The table opposite shows the potential investor barriers over the life cycle of investee projects and enterprise.[21]

Investor barriers can be classified into five market segments based on maturity of the company and the market. Each segment is differentiated by the type of capital needed by projects and enterprises at a specific stage of the investment life cycle, and the role played by philanthropic and development actors to overcome the investor barriers that exist at that stage.

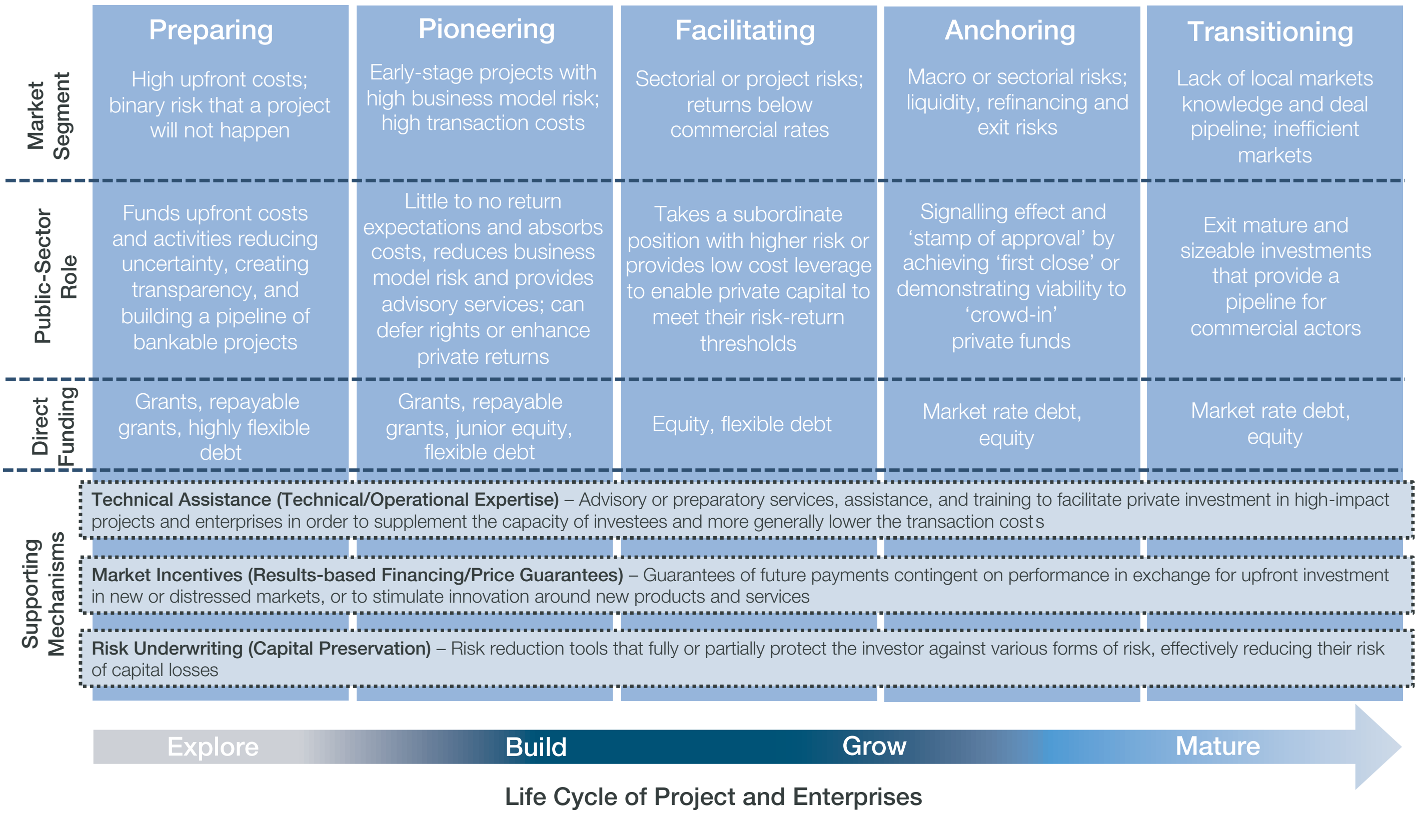
Given the diverse universe of projects and enterprises across sector and geographies, blended finance can be provided in many forms to address these barriers, either as tools to facilitate capital inflows through supporting mechanisms (grants, guarantees) or as complementary direct funding (grants, equity, debt). The graphs on the right show blended finance barriers and available interventions.

Investor barriers over the lifecycle of investee projects and enterprise



Direct funding for each market segment

Preparing	Preparation funding addresses the high upfront costs associated with pre-commissioned projects and feasibility exercises for new businesses. Funding at this stage is most often applicable to large infrastructure projects. It is typically in the form of grants, repayable grants or highly flexible loans.
Pioneering	Pioneering funding addresses the high risk and uncertain returns associated with early-stage investments, or projects using new technologies or in new markets, It is typically in the form of seed or venture capital that helps entrepreneurs to test and experiment with new ideas, markets, and / or business models.
Facilitating	Facilitating funding assists projects and companies that may offer low returns relative to the risks, which investors do not find to be commercially viable. By investing in the riskiest parts of the capital structure, development and philanthropic investors can make the private-sector investment more attractive. Direct funding at this stage takes a variety of forms including most often flexible or subordinate debt (i.e. mezzanine) and junior equity.
Anchoring	Anchoring funding from a development funder on the same terms as private-sector investment can provide comfort to investors, lowering the perceived ability to manage macro risks and increasing the perceived quality of the investment. Anchoring funding can be in the form of either market rate debt or equity.
Transitioning	Transitioning funding allows funding pools looking to invest in development sector access to a pipeline of deals that are sufficiently sizeable and scalable to fit within investor mandates



ANNEX D: Strategic decision-making process for country allocation, pipeline and mobilization

The allocation of public budgets and the selection of projects for which sources of capital beyond public budgets will be sought should be an inherent part of the country planning process for SDGs. As part of the strategic allocation/ financing process for the pipeline of projects identified as part of a country's sustainable development, it will be important for countries to recognize that maximizing the potential of private investment for SDGs requires an understanding of two important parameters that influence the ability of public capital to mobilize private capital. These include a recognition that:

- Private capital will be unlikely to support projects, business models or approaches that do not allow for adequate – often commercial – returns (risk-adjusted returns), even with blended or development finance support
- Not all projects, programmes or approaches that contribute to the SDGs will have these inherent return profiles, and many may not have the potential for these types of return profiles, and thus the ability of governments to engage private capital in investments along all SDG areas will vary

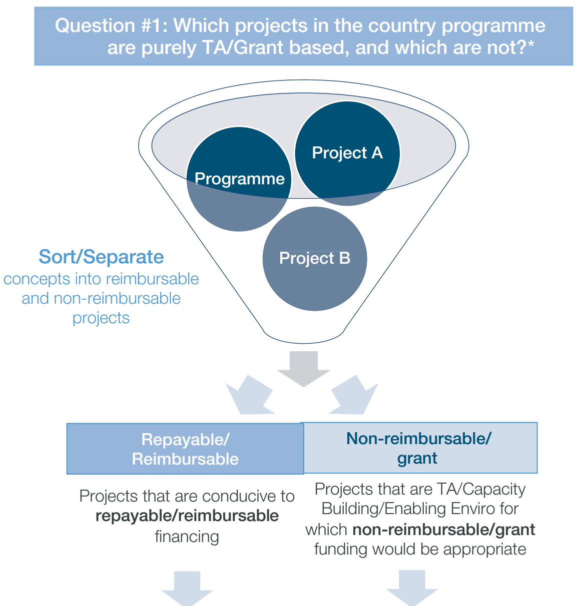
The following provides an illustrative approach to the decision-making process a country may undertake related to financing a programme of sustainable development investments, specifically related to understanding the types and sources of financing that may be applicable to funding those projects. This process is based on a "decision tree" approach that can sort projects based on their applicability and appropriateness for private capital, recognizing that not all projects, programmes or approaches that contribute to the SDGs will have inherent return profiles. In fact, many may not have the potential for return profiles that will be attractive to private capital, and thus the ability of governments to engage private capital in investments along all SDG areas will vary.

Illustrative process for strategic approach to financing SDG investments

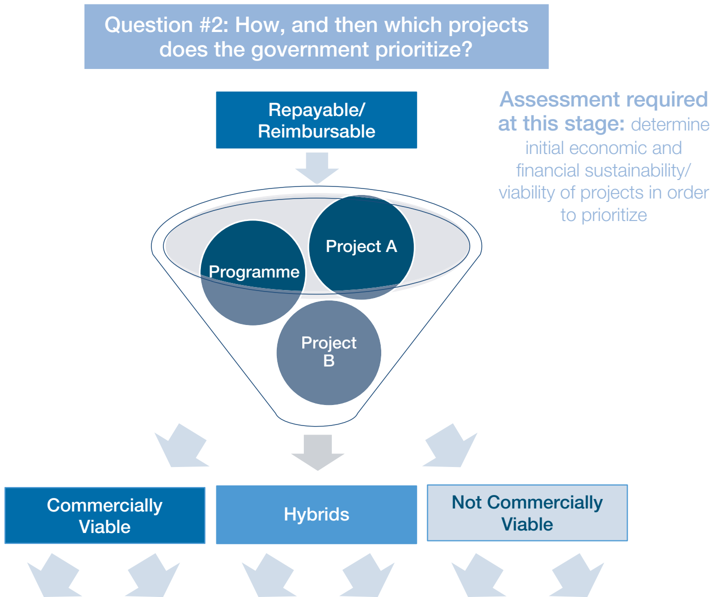
Step 1: The first step is for a country is to sort through the list of activities/projects associated with the strategic assessment of their country needs, and the associated pipeline of activities, and sort these into two primary categories (or "buckets") of activities:

a. **Non-reimbursable**: those projects that only require technical assistance/grant funds
b. **Reimbursable**: those that are expected to entail some form of repayable/reimbursable financing (regardless of type or source of such financing)

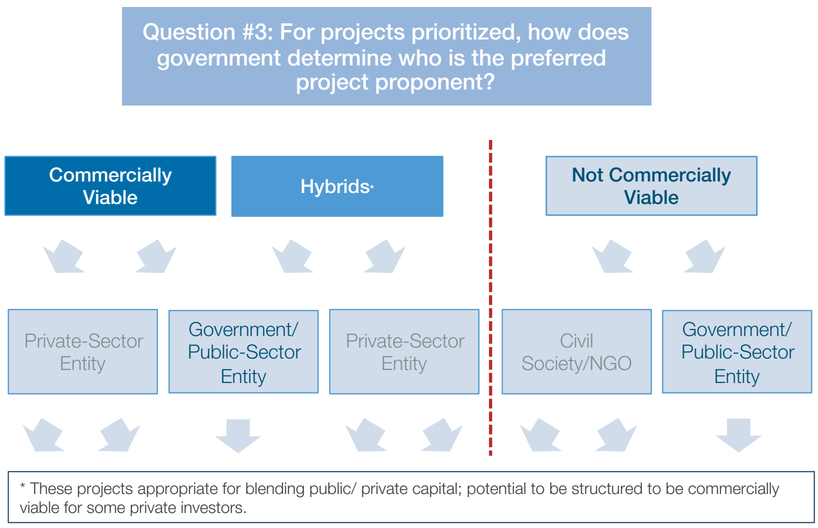
Examples of "projects/programmes" within a country programme that would be funded with purely grant/technical assistance (TA) include: regulatory and policy reforms, public-sector capacity-building, market-level interventions, etc. These "non-reimbursable" projects would follow a different strategic funding process but it will be important to allocate both (1) public funding and (2) development funding to these activities.



Step 2: Once projects for which non-TA funds are sought have been identified, countries will need to determine whether those projects are economically and financially viable, as this is a necessary condition for attracting private finance, whether purely as a part of project mobilization or in combination with other sources of patient/development capital (e.g. blended finance approaches). Through this process, governments may confront fundamental questions related to the role of the public enterprises (particularly for infrastructure projects that may be state-owned), and where and how to use scarce public budgets to attract private investment. Based on the assessment of economic and financial viability, they can develop a financial strategy that can provide funding and financing projects that meet their SDGs. This information will also help governments prioritize projects, including those that are publicly financed (including with development aid) and those where private capital can be "crowded in" either through blended finance approaches or directly.

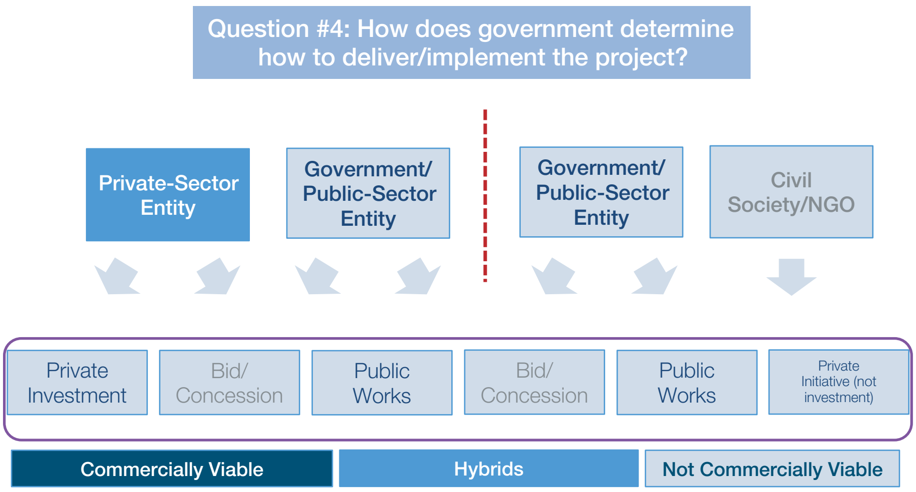


Step 3: In the country-driven process, governments will then have a level of information from which to make strategic decisions about which type(s) of entity should be the project proponent. Depending on the commercial viability of each project, governments can determine what type of entity is the most appropriate to develop/implement the project, (e.g. the government/public sector or private sector). Also, the government can use this information to consider employing approaches that are initiated by the private sector outside of the government decision-making process, and how best to prioritize the use of government support for those activities (e.g. through market support or development activities, policy/ legal/regulatory reforms, etc.).

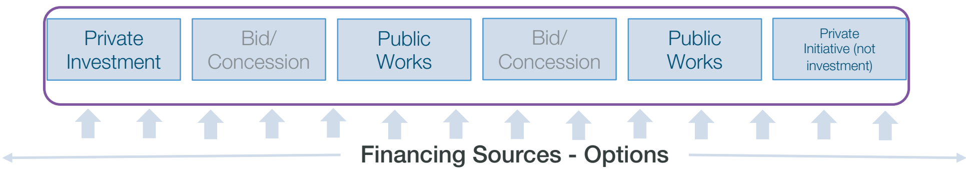


Step 4: Delivery partner: in some cases, particularly in PPP projects, the government has a role in determining who they want to implement/deliver the project, including: (1) public works; (2) PPP or bid/concession to private sector; or (3) fully private sector (owned and financed) without competitive bidding. Two important points at this stage are:

1. Projects that the government wishes to bid/tender or offer under a concession are likely to be developed through a government-led procurement process
2. Private-sector projects (private sponsors, privately financed) are possible only to the extent the government (and its regulations, enabling environment, etc.) is supportive; this may not be possible in all countries



Step 5: Develop a financing strategy for SDG-related investments: the potential for a project or investment to attract private financing is a function of: (1) commercial viability: (2) project proponent/sponsor: and (3) project delivery model (e.g. PPP, public, wholly private). Once the potential pipeline of projects has been sufficiently thought through to determine the appropriate projects that are viable for private finance, it will be easier to identify and map the types and sources of financing/funding that can support these types of projects. This includes those projects that require a blended finance approach whereby combining different patient, risk-bearing and/or concessional sources can stimulate private capital. The universe of financing/funding options can be viewed along **a continuum from market-based to grant possibilities**.



Market-Based/Commercial		Concessional/Blended		Grant/TA
Possible Source	**Instrument**	**Possible Source**	**Instrument**	**Possible Source**
Investors, PE, VCs	Equity	Impact Investors	(patient) Equity	Impact Investors
Commercial Banks	Debt, Guarantees/RSF	DFI/MDB/NDB/ Bilateral dev banks	LT Debt (IDA terms), Guarantees	DFI/MDB/ Bilateral/National dev banks
Institutional Investors	Bonds, Debt	DFI/MDB/NDB/ Bilateral dev banks	Debt, Equity, Guarantees/RSF	Bilateral Donors
DFI/MDB/NDB/ Bilateral dev banks	Debt, Equity, Guarantees (on commercial terms)	Philanthropy	Debt, Equity, Reimbursable/PB Grants (concessional)	Philanthropy
ECAs/MIGA	Risk mitigation via Guarantees (PRG, etc), other products	Multilateral Funds (GCF, CIFs, etc.), Bilateral Donors	Debt, Equity, Guarantees/RSF/1st loss (concessional)	

Endnotes

1. UNCTAD, *World Investment Report 2014: Investing in SDGS: An Action Plan*, https://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=194 (link as of 14/12/18).
2. International Finance Corporation, *DFI Working Group on Blended Concessional Finance for Private Sector Projects*, October 2017: https://www.ifc.org/wps/wcm/connect/30635fde-1c38-42af-97b9-2304e962fc85/DFI+Blended+Concessional+Finance+for+Private+Sector+Operations_Summary+R....pdf?MOD=AJPERES (link as of 17/1/19)
3. Ibid.
4. G20 Eminent Persons Group report on Global Financial Governance, *Making the Global Financial System Work For All*: https://www.globalfinancialgovernance.org/report-of-the-g20-epg-on-gfg/ (link as of 17/1/19)
5. Unlike the SDGs, which evolved from the Millennium Development Goals, the Paris Agreement was built on a country-driven, bottom-up process in which countries' climate pledges (which collectively form the global ambition of the Paris Climate Agreement) were based upon each country's own assessment of its ability to reduce emissions and contribute to meeting the overall global climate change goals of limiting warming to 1.5–2°C above pre-industrial levels. As a "country-driven" process, NDCs were intended to take into account a country's capabilities with regards to emission reduction and adaptation, given their varying levels and stages of development.
6. Ibid.
7. The Global Impact Investing Network's (GIIN) Gender Lens Investing Initiative supports impact investors, who are actively integrating, or interested in integrating, a gender lens strategy into their investment portfolio, and includes interventions focused specifically on the improved economic and social well-being of women and girls. Thematic strategies might include investing in businesses that promote workplace equity and women's leadership, investing in companies offering products and services that benefit women and girls, investing in issues that disproportionately affect women and girls, or providing access to capital for women-owned or –led businesses. See: https://thegiin.org/gender-lens-investing-initiative (link as of 25/03/19).
8. The World Economic Forum and OECD define blended finance as "the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets". Blended finance deliberately channels private investment to sectors of high-development impact while at the same time delivering risk-adjusted returns. *Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders*.
9. *Summary Report and Next Steps: Getting Government's Organized on the Sustainable Development Goals*, High Level Political Forum, New York 18 July 2017, OECD.
10. Some countries have existing planing processes for certain SGD goals (e.g. SDG 7: Affordable and Clean Energy), which employ processes for developing a pipeline of transactions and (in theory) attracting financing for those projects. These processes can be employed and improved and can inform country-level SDG planning processes.
11. It should be noted that governments at lower levels play a vital role in both planning and service delivery. In many decentralized environments, such governments have service delivery responsibilities, but they may have less ability to directly impact funding allocations, and in many places they face more severe funding/financing constraints than the central government. The project/planning life cycle illustrated above can also be useful at the subnational and municipal levels, although the role of the central government in (financially) supporting subnationals is in many countries a key issue.
12. The illustrative "project cycle" builds on the project life cycle from the *Blended Finance Vol 1: A Primer for Development Finance and Philanthropic Funders*. It is important to note that this illustration is applicable for projects with potential for exploiting private capital, which (by definition) implies the potential for future commercial viability. Portions of this project cycle cover approaches for direct private investment and blending of public/development capital at the project level, and also includes reference to additional activities – notably market enabling, technical assistance and capacity building, which will be crucial for creating the environment to attract private capital. Most of these activities are grant-based and require public funding. This project cycle would not be applicable for projects that are by their nature fully public, and which do not have return profiles that could attract private investment.
13. OECD, *Total Official Support for Sustainable Development (TOSSD): A New Statistical Measure for the SDG Era*, January 2019: http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/TOSSD-A-New-Statistical-Measure-for-the%20SDG-Era.pdf (link as of 1/4/19).

14. Sean Gilbert and Lihuan Zhou, "The Knowns and Unknowns of China's Green Finance", New Climate Economy: https://newclimateeconomy.report/workingpapers/wp-content/uploads/sites/5/2017/03/NCE2017_ChinaGreenFinance_corrected.pdf (link as of 14/12/18).

15. *"Synthesis of the Main Messages of the Reports of Voluntary National Reviews"* (2018): https://sustainabledevelopment.un.org/content/documents/20027SynthesisofMainMessages2018_0607.pdf. (link as of 14/12/18).

16. David Beal, Julia Dhar and David Young, "Narrowing the SDG Investment Gap" 2018, Boston Consulting Group: https://www.bcg.com/en-ca/publications/2018/narrowing-sdg-investment-gap-imperative-development-finance-institutions.aspx (link as of 14/12/18).

17. Nancy Lee, "The Eight Virtues of Highly Effective DFIs", Center for Global Development: https://www.cgdev.org/blog/eight-virtues-highly-effective-dfis (link as of 14/12/18).

18. Ibid.

19. It should be noted that capacity gaps also exist in the private sector, both in the financial sector and in the real sector, particularly for understanding the relative investment potential of the sustainable development goals, and approaches to effectively build a pipeline of investments that meet the SDGs.

20. *"G20 Eminent Persons Group on Global Financial Governance: Update for the G20 Meeting of Finance Ministers and Central Bank Governors"*, March 2018.

21. This section (including tables and charts) is adapted from section 4.3 of the World Economic Forum Blended Finance Vol. 1 Report. For the original text, please refer to: *World Economic Forum: Blended Finance: A Primer for Development Finance and Philanthropic Funders*, 14 July 2015.

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