Financing for Sustainable Development Report 2020

Inter-agency Task Force on Financing for Development

This report is a joint product of the members of the Inter-agency Task Force on Financing for Development. The Financing for Sustainable Development Office of the United Nations Department of Economic and Social Affairs serves as the coordinator and substantive editor of the Financing for Sustainable Development report.

The online annex of the Task Force (http://developmentfinance.un.org) comprehensively monitors progress in implementation of the Financing for Development outcomes, including the Addis Ababa Action Agenda and relevant means of implementation targets of the Sustainable Development Goals. It provides the complete evidence base for the Task Force's annual report on progress in the seven action areas of the Addis Agenda (chapters III.A–III.G). The report is by necessity more concise and selective and should thus be read in conjunction with the online annex.

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INTERNATIONAL DEVELOPMENT COOPERATION



Chapter III.C

International development cooperation

1. Key messages and recommendations

The 2030 Agenda for Sustainable Development will place significant demands on public budgets and capacities that require scaled-up and more effective international support, including both concessional and non-concessional financing. Yet, in 2018, official development assistance (ODA) declined by 4.3 per cent and remains well below the 0.7 per cent commitment in the Addis Agenda. The decline was due in large part to a decrease in financing for refugees in donor countries; however, gross ODA to least developed countries (LDCs) also fell by 2.2 per cent in real terms. ***The Inter-agency Task Force on Financing for Development calls on ODA providers to reverse the decline in ODA, particularly to LDCs, and strongly reiterates previous calls for ODA providers to step up their efforts to meet commitments made in the Addis Ababa Action Agenda***.

South-South cooperation (SSC) continues to expand in scope, volume and geographical reach. ***As the role of SSC and triangular cooperation deepens, documenting its added value and impact on sustainable development by relevant stakeholders could further support implementation of the Sustainable Development Goals.***

The Addis Agenda also recognizes the important role of development banks in implementation of the 2030 Agenda. In 2019, several multilateral development banks (MDBs) completed successful capital replenishments. In addition, some MDBs have taken steps to raise additional resources through innovative mechanisms. ***Other development financial institutions (DFIs) can learn from innovative efforts to raise additional resources, including risks that need to be managed***. MDBs have also increased efforts to align activities with the Addis and 2030 Agendas. ***These activities should be continued and stepped up to fully align activities to the 2030 Agenda, including harmonizing gender-equality monitoring indicators***.

The recent spread of the coronavirus has also raised questions on whether available resources are sufficient to help countries prevent and respond to epidemics and pandemics. Experience from responses to disasters and other hazards indicate ***the need for ex ante financing instruments, which are efficient, predictable and quick-dispensing and build incentives for risk reduction into their design. This includes an increased focus on investing in disaster risk reduction, including epidemic and pandemic prevention and preparedness.***

This chapter also explores a range of public finance instruments to raise resources for the Sustainable Development Goals (SDGs) in the context of international development cooperation, building on the financial instruments laid out in chapter III.B. ***Such public finance instruments are not panaceas to fill the investment gap, but can be useful tools to make aid more effective and leverage other types of finance when appropriate.***

Blended finance is one instrument that has received significant attention. While blended finance has grown rapidly, the evidence on its development impact is less robust. Most blended finance currently goes to middle-income countries, motivated by the size and ease of transactions, with only a small portion going to LDCs, in part because blended finance is not appropriate for all investments or activities. To increase effectiveness, concessional resources should be allocated where the need and impact are greatest. ***Blended finance needs to switch from a search for bankability to a search for impact, based on country needs and ownership, with judicious use of blending in circumstances where it is determined to be the best suited tool. Capacity development support towards these efforts can help countries identify and apply appropriate instruments.***

In the next 10 years, many developing countries are expected to transition to higher income per capita status. Higher incomes can be translated into tangible SDGs progress. Nonetheless, this positive news comes with challenges, especially for graduates that are highly vulnerable to climatic events and other disasters, as graduating countries may lose access to concessional finance windows. In response, ODA providers are including greater flexibilities for these types of vulnerabilities and for conflict/

political instability. However, ***there are areas for improvement for all graduation contexts (LDC graduation, graduation from multilateral concessional windows, ODA graduation, etc.), including emphasis on pre-graduation planning (including addressing simultaneous graduations); capacity development focused on areas where financing constraints may be greatest (e.g., for domestic resource mobilization and debt management); and strengthening exceptional and temporary support measures for countries in transition, including having a process for reverse graduation***.

Efforts to increase and improve access to ODA, as well as to mobilize additional resources for development, must be matched by efforts to improve the quality, impact and effectiveness of development cooperation. ***Countries should aim to better link their plans, strategies and resources, while development partners should make more effort to align their interventions to country priorities. Integrated national financing frameworks (INFFs) can be a useful tool to improve the effectiveness of development cooperation by matching plans, strategies and resources.***

This chapter starts by examining trends in international development cooperation. As requested in the 2019 ECOSOC Financing for Development Forum outcome document, the chapter then takes a more in-depth look into two areas: (i) public finance instruments to strengthen the effectiveness of development cooperation and (ii) challenges countries face in graduation from concessional finance windows. It concludes with an update on development cooperation effectiveness.

2. Trends in international development cooperation

2.1 Official development assistance

In 2018, ODA provided by members of the Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) amounted to $153 billion, as calculated by the new OECD grant-equivalent methodology (box III.C.1). The 2018 figure is equivalent to 0.31 per cent of the combined gross national income (GNI) of the DAC, well below the United Nations target of 0.7 per cent. Five DAC members (Denmark, Luxembourg, Norway, Sweden and the United Kingdom of Great Britain and Northern Ireland) met or exceeded the 0.7 per cent target.

Using the previous cash-flow methodology for comparative analysis, total net ODA to developing countries fell by 4.3 per cent in 2018 (figure III.C.1). ODA to LDCs fell by 2.1 per cent and accounted for only 0.09 per cent of DAC members' GNI, below the 0.15-0.20 per cent LDC target. The same five DAC members that met the 0.7 target also met the target for LDCs. ODA to Africa, landlocked developing countries (LLDCs) and small island developing States (SIDS) all fell by 1.8, 8.9 and 2.1 per cent, respectively (figure III.C.1).

ODA allocation

The fall in gross ODA disbursements was due in large part to a fall in ODA for refugees in donor countries (figure III.C.2). Country programmable aid (CPA), which is provided cross-border to countries and regions (and excludes donor refugee costs, humanitarian aid, debt relief, and administrative costs), increased slightly, by 0.3 per cent. However, in LDCs, LLDCs and African countries, CPA fell by 1.1, 7.2 and 0.1 per cent, respectively (figure III.C.3).

The allocation of ODA should align with country priorities and plans (see section 4). The slight increase in CPA in 2018 was led by higher disbursements in the social sector versus a decline in production sectors (figure III.C.3). In particular, CPA to the education subsector increased for all country groups.

ODA concessionality

Grants make up the majority of bilateral ODA to developing countries (83 per cent), followed by concessional loans (16 per cent) and equity investment (1 per cent) (figure III.C.4). This composition has been relatively unchanged since 2015, although there have been some changes to the sectoral allocation (figure III.C.5). Since 2015, there has been a slight fall in grant financing to the social sectors, though these are still more than 90 per cent grant financed, with production sectors being about 80 per cent grant financed. There is less grant financing channelled into the economic sectors, which are more often able to generate their own revenue streams and are almost two thirds financed by concessional loans.

ODA to LDCs, SIDS and LLDCs are largely in the form of grants—90, 91 and 93 per cent, respectively. However, since 2015, there has been a decline in concessionality for LDCs and LLDCs (figure III.C.4). For LDCs, concessionality fell across all sectors, although the decline was more pronounced in economic sectors, particularly for projects related to transport and storage.

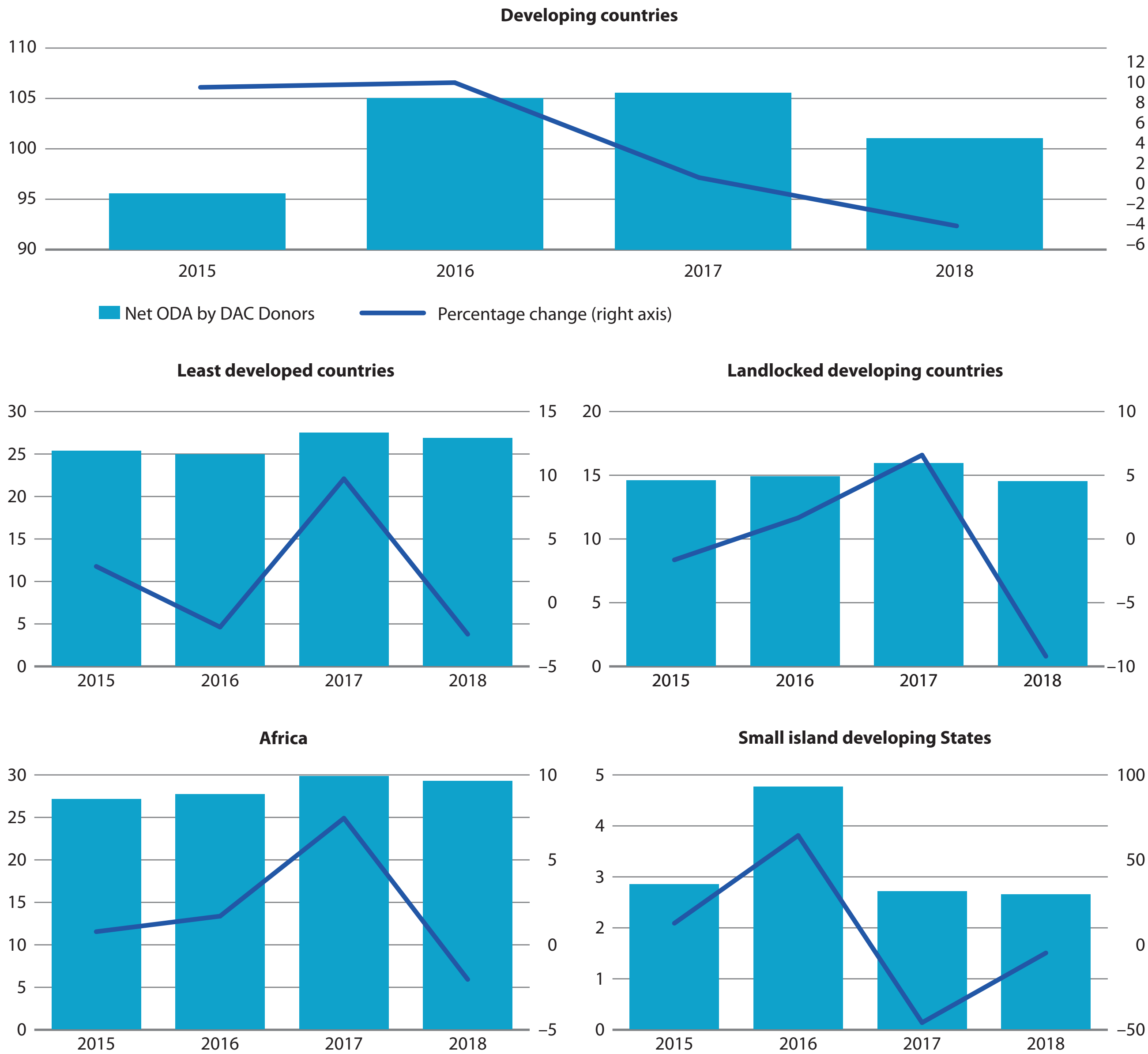
Measuring official development assistance for the Sustainable Development Goals

To better track the contribution of ODA to the SDGs, the OECD is introducing an SDGs tracker, which uses artificial intelligence to link ODA and other development flows to the SDGs. For example, according to the tracker, in 2017, 16 per cent of gross ODA disbursements by DAC members were dedicated to the achievement of SDG 10 (reduced inequalities), 11 per cent towards SDG 3 (good health and well-being), and 10 per cent each to SDG 2 (zero hunger), SDG 16 (peace, justice and strong institutions) and SDG 17 (partnerships) (figure III.C.6).

The breakdown of ODA by SDGs is derived from a machine-learning algorithm based on the creditor reporting system (CRS) database. To link the projects to the SDGs, the algorithm "reads" the textual description of each aid project, identifies patterns of text attributed to SDGs and links a project to zero, one or multiple SDGs.

The OECD will also continue to measure the SDG alignment of development finance more broadly,[1] and also refine the algorithm going forward. Quality checks and verification against other markers are being assessed to fine-tune the results, as in its current form the algorithm may underestimate SDGs to cross-cutting areas, such as gender. For example, according to the CRS gender marker on preliminary figures, bilateral aid focused on gender equality and women's empowerment is increasing, accounting for 46 per cent of total bilateral allocable aid in 2018 (figure III.C.7), well above the SDG tracker of 2 per cent. However, the CRS gender marker found that programmes dedicated to gender equality and women's empowerment as the principal objective amounted to 4.5 per cent of DAC members' total aid, which is more in line with the machine-learning algorithm results.

Figure III.C.1
Total Net ODA by DAC members by country group on a cash basis, 2015–2018
(Billions of United States dollars, 2017 constant prices)



Source: OECD/DAC data.

2.2 Humanitarian finance

In 2019, humanitarian response plans and appeals coordinated by the United Nations required $29.7 billion, of which $18 billion (61 per cent) was received. Together with additional funding contributions outside these response plans and appeals, global humanitarian funding reported was $24.1 billion.[2] The 2016 Grand Bargain made by 18 donor countries and 16 aid organizations to improve the efficiency and effectiveness of humanitarian finance has resulted in substantial progress.[3] Improvements were made in cash programming, multi-year collaborative and flexible planning/funding, harmonized reporting, as well as enhanced coordination.[4] However, there are remaining challenges to further consolidating efforts and reducing bureaucracy to meet the full potential of the Grand Bargain.[5]

2.3 Multilateral development banks

The Addis Agenda also calls on MDBs to better leverage their balance sheets to increase lending for sustainable development, as well as to align their policies in support of the 2030 Agenda.

Box III.C.1
Official development assistance modernization and total official support for sustainable development

Official development assistance modernization

In 2019, the Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) introduced a change to the methodology to calculate official development assistance (ODA), based on the 2014 DAC decision. From 2018, ODA is calculated using a grant-equivalent measure. Under the old cash flow methodology, the full face value of a loan was counted as ODA and repayments were subtracted when they were paid out. The new grant-equivalent methodology calculates the grant portion of a loan by calculating the amount of lending that is concessional (i.e., below market rates), rather than including the full face value. Future repayments are not subtracted from the ODA total.

The 2018 figures start a new grant-equivalent ODA series, as the new grant-equivalent figure is not comparable with historical ODA data. However, the OECD will continue to publish ODA data on a cash basis to allow analysis of trends over time. The change in the methodology resulted in slightly higher gross ODA levels (by 2.5 per cent).

Total official support for sustainable development

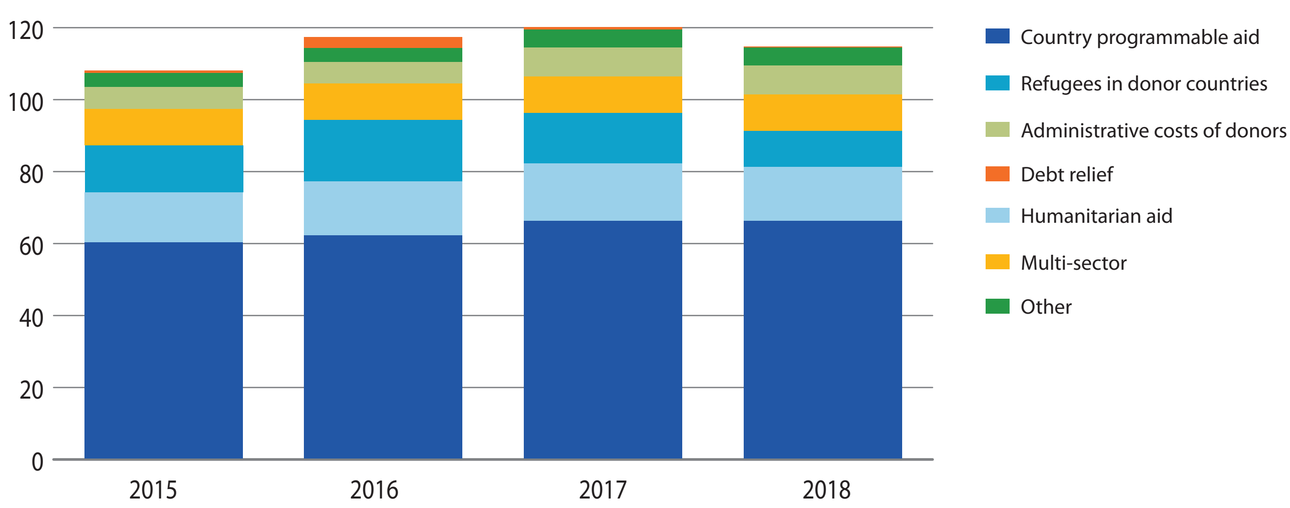
Initiated by the OECD, total official support for sustainable development (TOSSD) is a statistical framework for measuring official external resources and private finance mobilized by official interventions, in support of sustainable development and the Sustainable Development Goals (SDGs). The TOSSD framework aims to capture both cross-border resource flows to recipient countries, as well as data on resources invested to support development enablers, international public goods (e.g., climate change) and to address global challenges.

Following the call by the Addis Ababa Action Agenda to develop TOSSD in an open, inclusive and transparent way, the OECD established an International Task Force in July 2017 to develop the TOSSD statistical methodology. In June 2019, the Task Force finalized the first version of the TOSSD methodology. A TOSSD data survey was also carried out, to which 43 countries and organizations responded, identifying new activities that were not previously reported in OECD statistics.

The Inter-agency and Expert Group on SDG Indicators agreed that it would be beneficial to include an additional indicator in the SDGs global indicator framework to measure development support in the broadest sense that goes beyond ODA. However, the Expert Group was not fully in agreement with the TOSSD methodology and agreed to the establishment of a working group to further consider the methodology and submit a recommendation to the United Nations Statistics Commission in 2022.

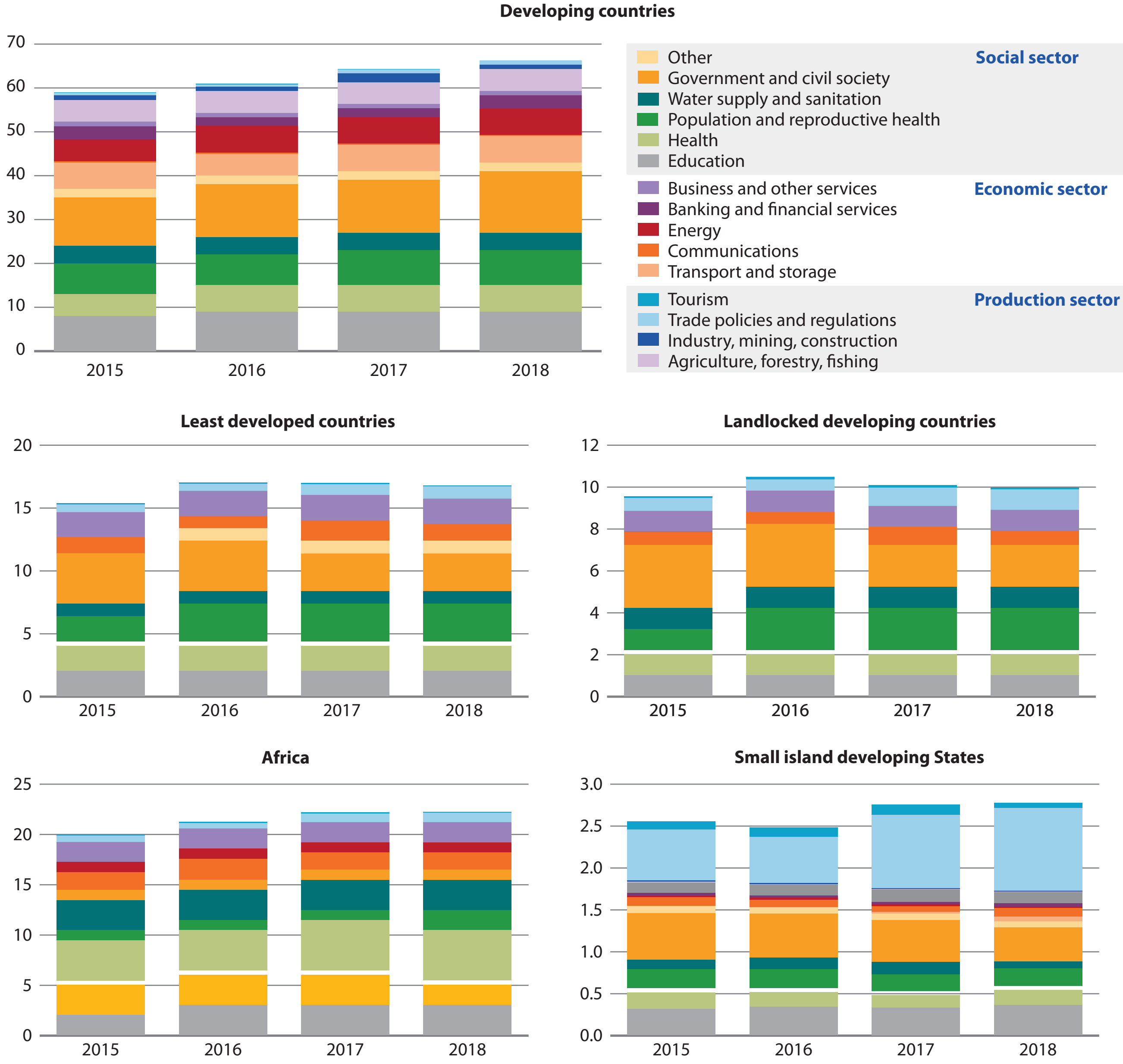
Source: OECD, "Modernisation of the DAC Statistical System," (2019); Economic and Social Council resolution E/CN.3/2020/2.

Figure III.C.2
Gross ODA disbursements by DAC members to developing countries on a cash basis, 2015–2018
(Billions of United States dollars, 2017 constant prices)



Source: OECD/DAC data.

Figure III.C.3
Country programmable aid by sector on a cash basis, 2015–2018
(Billions of United States dollars, 2017 constant prices)



Source: OECD/DAC data.

Trends in lending and capital replenishments

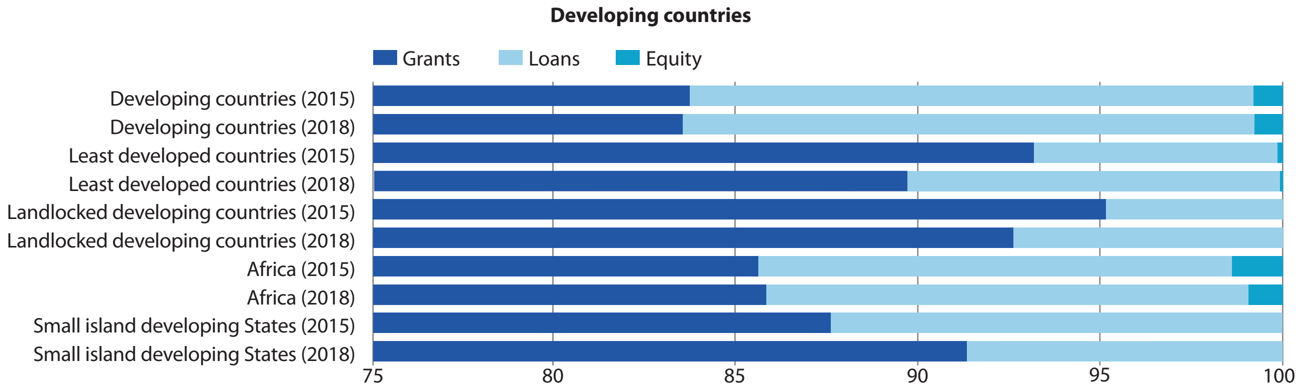
In 2018, total lending by MDBs rose 4.7 per cent to $71.9 billion (figure III.C.8). Concessional lending, primarily from the International Development Association (IDA), accounted for about 18 per cent of the total (figure III.C.8), with the major recipients being LDCs (67 per cent).

In December 2019, IDA was successfully replenished with $82 billion for the fiscal years 2021-2023 (IDA19),[6] 7 billion more than the previous replenishment in 2016. Also, in 2019, shareholders of the AfDB approved a $115 billion capital increase, the largest since its establishment in 1964.[7] The African Development Fund, the concessional fund of the AfDB, was also replenished by $7.6 billion for the 2020-2022 period, an increase of 32 percent from the previous cycle.[8]

Optimization of resources

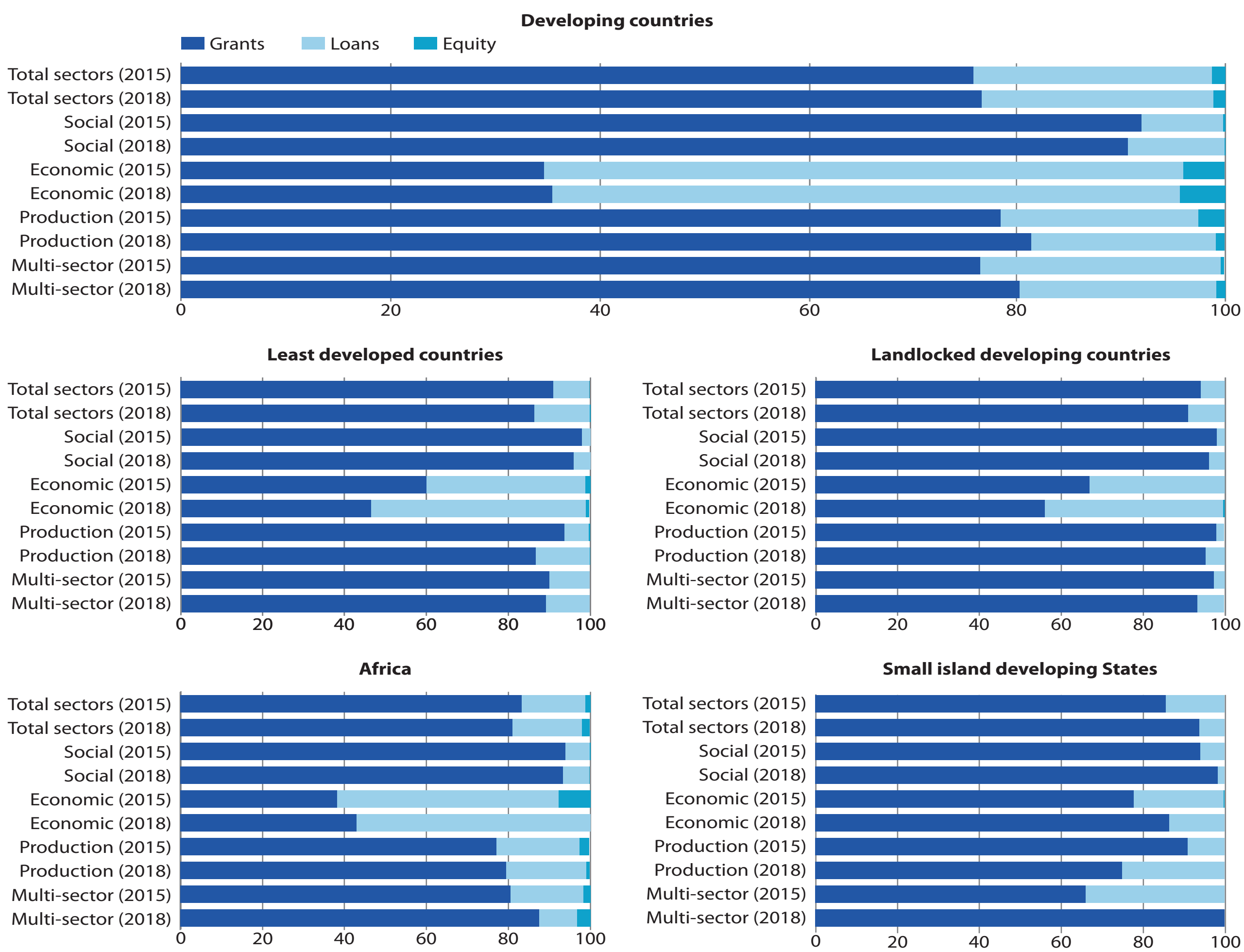
The Addis Ababa Action Agenda calls on MDBs to make optimal use of their balance sheets to increase lending. In 2019, several MDBs[9] agreed

Figure III.C.4
Gross bilateral ODA disbursements to country groups by instrument on a cash basis, 2018/2015
(Percentage of total)



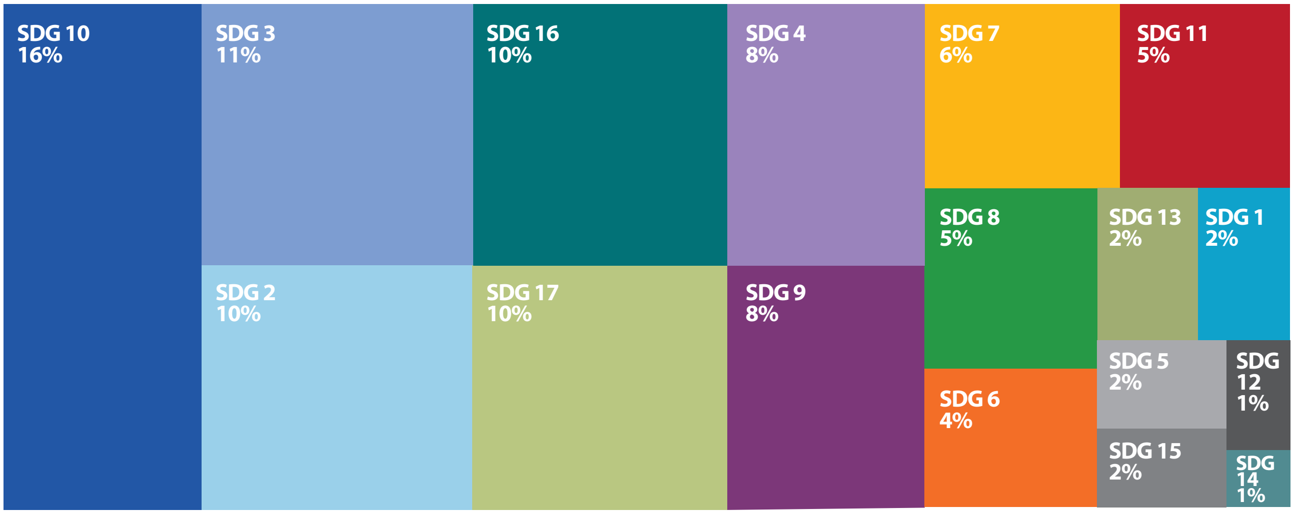
Source: OECD/DAC data.

Figure III.C.5
Gross bilateral ODA disbursements to country groups by instrument and selected sectors on a cash basis, 2018/2015
(Percentage of total)



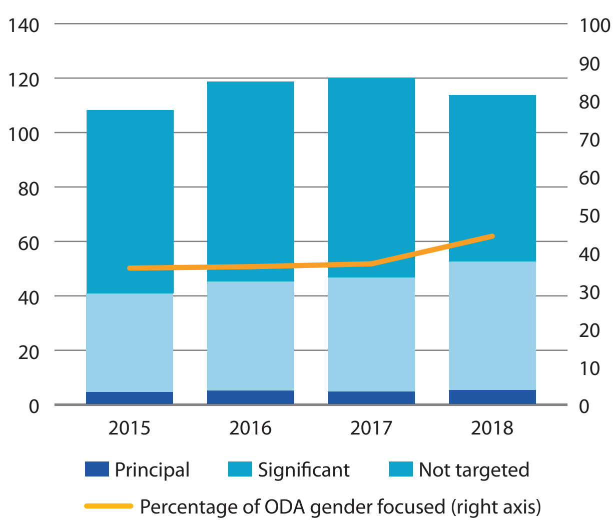
Source: OECD/DAC data.

Figure III.C.6
Gross ODA disbursements by SDGs, 2017
(Percentage of total)



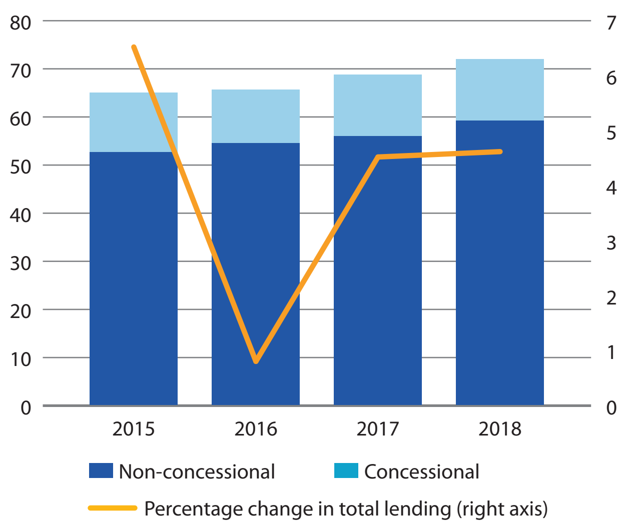
Source: OECD SDG Financing Lab based on OECD/DAC data.

Figure III.C.7
ODA to gender equality and women's empowerment, 2015–2018
(Billions of United States dollars, 2017 constant prices)



Source: OECD/DAC data.

Figure III.C.8
Lending by multilateral development banks, 2015–2018
(Billions of United States dollars, current)



Source: World Bank, International Debt Statistics.

to a common "value for money" framework to optimize their resources.[10] MDBs have already taken several actions in this area, including merging concessional windows with ordinary capital; securitizing balance sheets; and insuring or reinsuring risks. For example, the merger of the windows of the Asian Development Bank (ADB) is expected to increase annual loan and grant approvals by over 50 per cent, to over $20 billion by 2020.[11] The AfDB synthetic security (see section 3.2)[12] made space for $650 million more in loans.[13] The AfDB and African Trade Insurance completed a credit insurance deal worth $500 million to cover non-sovereign loans, which made headroom of $400 million. The European Bank for Reconstruction and Development (EBRD) has used unfunded risk participations, where privately owned insurance or reinsurance companies take on the risk exposure of a portion of EBRD loans, signing €1.2 billion worth of deals since 2014, including over €500 million in 2019.[14]

Mobilization of private finance is one of the indicators of the common framework. The total amount mobilized by MDBs amounted to $69.4

billion, which includes direct and indirect mobilization. Direct mobilization totalled $20.2 billion in 2018, similar to 2017, with $2.9 billion for LDCs and other low-income countries[15] (see section 3.1).

MDBs also recognized the importance of gender equality as one of the indicators in the common framework, with an MDB Working Group on Gender looking to strengthen harmonization of indicators.[16] These efforts are similar to those currently considered by the United Nations system, following recommendations by a High-level Task Force on Financing for Gender Equality.

Addressing debt risk

Many low-income countries that borrow from MDB concessionally have the dual challenges of managing raising resources and rising debt levels (see chapter III.F). For example, more than one third of IDA countries are at high risk of or in debt distress. To help countries manage this risk, the World Bank will replace its non-concessional borrowing policy with the Sustainable Development Finance Policy (SDFP).[17] The objective of the SDFP is to incentivize countries to borrow sustainably and promote coordination between IDA and other creditors in support of borrowing countries' efforts. On the demand side, a Debt Sustainability Enhancement Program (DSEP) aims to incentivize countries with elevated debt vulnerabilities to implement concrete policy and performance actions (PPAs) aiming to enhance fiscal sustainability, debt management, and debt transparency. Countries successfully implementing their annual PPAs will have access to their full country allocations; otherwise, a portion of their country allocations will be set aside but could be released a year later if PPAs are successfully completed. The second pillar of the SDFP is the Program of Creditor Outreach, which aims to promote stronger collective action and coordination among borrowers and creditors to mitigate debt-related risks.

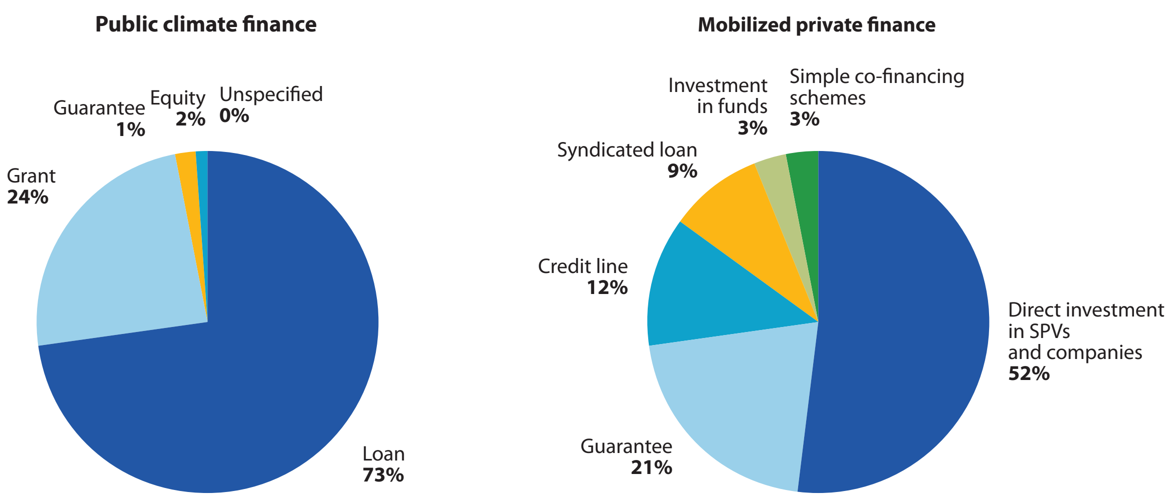
2.4 Climate finance

According to the Standing Committee on Finance of the United Nations Framework Convention on Climate Change (UNFCCC), climate-specific finance provided through bilateral and multilateral channels reported by developed countries to developing countries amounted to $38 billion in 2016.[18] More recent estimates by the OECD signal an increasing trend in both public flows and mobilized private flows for climate action, including to LDCs and SIDS.[19] Climate finance remains skewed towards mitigation compared to adaptation activities, except in the case of LDCs and SIDS where financing is more balanced.[20] The majority of climate finance is provided through loans, with grant financing making up about a quarter of public climate finance (figure III.C.9).

MDB[21] climate finance commitments rose by 22.4 per cent over the year to $43 billion in 2018.[22] The AfDB recently announced that it would no longer finance coal projects, joining the World Bank Group (WBG), EBRD and European Investment Bank (EIB) that have explicit policies in this area. The ADB and Asian Infrastructure Investment Bank (AIIB) also made statements that they do not intend to finance coal.[23] In addition, the EIB announced that it would end all fossil fuel lending by 2022.[24] At the United Nations Climate Change Conference (COP25), held in Madrid in December 2019, MDBs indicated that the full implementation of the joint framework for aligning activities with the goals of the Paris Agreement would be implemented by 2023-2024.[25]

In October 2019, 27 countries pledged to replenish the Green Climate Fund (GCF) by $9.78 billion—equivalent to funding for the next four years—up from $9.3 billion in the previous pledging conference in 2014.[26] As of November 2019, the GCF had approved total funding of $5.6 billion for 124 projects and programmes, with co-financing of $15 billion.[27] LDCs, SIDS and African States accounted for 25.0 per cent, 18.8 per and 39.2 per cent of approved projects, respectively.[28]

Figure III.C.9
Climate finance instruments
(Percentage)



Source: OECD, Climate Finance Provided and Mobilised by Developed Countries in 2013-17 (Paris, 2019).
Note: SPV – special purpose vehicle.

MDBs and climate finance funds can also capitalize on the unique role of national development banks, including through the International Development Finance Club, to crowd in the private sector or intermediate funds.

Even as climate finance flows increase, enhancing access and improving its effectiveness remain critical. The accreditation process remains complicated, time-consuming and disjointed, making it difficult for developing countries to access, especially those with limited technical capacity.[29] Despite ongoing efforts, a more coordinated and complementary approach by bilateral and multilateral agencies is required to overcome the complex and fragmented climate finance architecture.[30] As women are often disproportionally affected by the climate crisis, gender perspectives should be incorporated into operational and policy frameworks, as GCF has demonstrated from the outset.[31] More broadly, it is important that development cooperation activities are aligned with climate action and that development financing activities do not undermine sustainable development.[32]

2.5 Emergency health finance

The spread of the coronavirus (COVID-19) has raised questions of whether resources are sufficient. The World Health Organization (WHO) estimated that it needed $675.5 million to combat COVID-19. By mid-March 2020, WHO received $103.4 million. WHO also received $15 million from the Central Emergency Response Fund (CERF) and $9.5 million from the Contingency Fund for Emergencies (CFE). [33] The CERF is a grant-making facility started in 2006 to fund very early responses to humanitarian emergencies and to support humanitarian response activities, while the CFE gives WHO the resources to respond quickly to disease outbreaks and humanitarian crises with health consequences. Other mechanisms to address pandemics include the World Bank Pandemic Emergency Financing Facility (PEF) (section 3.3). However, there are concerns over the sustainability of these mechanisms, due to the limited support by donors. For example, only three donors account for most of the funding to the CFE (75 per cent) and PEF (100 per cent).[34]

The World Bank has made available a $14 billion package of fast-track financing to assist countries and companies in their efforts to respond to COVID-19, as well as a number of other facilities that countries can potentially access during crises, including the Contingent Emergency Response Components (CERCs), the "Catastrophe Deferred Drawdown Option" (see section 3.3), [35] and the Crisis Response Window (CRW) for IDA-eligible countries. The IMF has also made available rapid-disbursing emergency financing of about $10 billion for low-income countries and $40 billion for emerging markets. In addition, the IMF is providing eligible countries up-front grants for relief on IMF debt service, but this facility is currently underfunded with just over $200 million available against possible needs of over $1 billion.[36] Other MDBs have also announced COVID-19 response packages to assist countries – EIB (€40 billion),[37] ADB ($6.5 billion),[38] Inter-American Development Bank (IDB) ($2 billion)[39] and Islamic Development Bank ($730 million).[40]

The rapid spread of the COVID-19 outbreak and its impact on global economic activity reaffirms that investment in prevention and risk reduction also makes economic sense (see chapter I). Much greater investment is therefore needed, particularly in the form of ODA in LDCs and SIDS, to build technical and governance capacities, share technologies, and strengthen data for an integrated and systemic approach to risk reduction.

2.6 South-South cooperation

In March 2019, the second High-level United Nations Conference on South-South Cooperation (BAPA+40) highlighted the evolution of South-South cooperation (SSC) over the decades, and its emerging role in the implementation of the 2030 Agenda.[41] As a complement to North-South cooperation, SSC has expanded its scope, facilitated regional integration and provided innovative approaches for collective action.[42]

The growth of SSC in volume and geographical reach, has also resulted in context-specific approaches, modalities, instruments, patterns and scales of SSC, which has made it difficult to develop a common definition of SSC[43] and a standardized approach to quantifying SSC flows.

Twenty non-DAC countries that report to the OECD averaged $15.2 billion in development assistance between 2015 and 2017.[44] A few countries have provided more than 0.7 per cent of their GNI, including Turkey and the United Arab Emirates. Qatar and Saudi Arabia have also previously exceeded the 0.7 per cent threshold. Arab providers account for almost half of non-DAC reported development assistance, with flows directed mainly through grants for the Middle East and North African region.[45]

Developing countries are also advancing BAPA+40 calls to developed-country-led systems for data collection, quality assessment, and monitoring and evaluation. For example, the Government of Mexico is further refining a pilot framework to monitor the effectiveness of its SSC, which it developed in 2018. The results of the pilot are also being used to inform the next iteration of the country's national development cooperation policy.

Globally, triangular cooperation continues to expand and to enhance its effectiveness, Voluntary Guidelines for Effective Triangular Cooperation were launched in 2019, emphasizing country ownership; shared commitments; a focus on results; inclusive partnerships and multi-stakeholder dialogues; transparency and mutual accountability; innovation; joint-learning and knowledge-sharing; the advancement of gender equality; and leaving no one behind.[46]

3. Public finance instruments

Public finance instruments aim to raise resources for sustainable development and increase the effectiveness of development cooperation. While some of the mechanisms discussed in this section overlap with the trends laid out in section 2 above (e.g., concessional finance from DAC donors used in these instruments is generally included in ODA statistics), these "innovative instruments" are meant to complement existing forms of development cooperation.[47]

The concept of innovative public finance in development cooperation has evolved considerably since Member States of the United Nations agreed in the Monterrey Consensus in 2002 to explore such measures. While the earlier discussions on innovative finance highlighted solidarity taxes to raise resources, along with measures to better manage aid flows (e.g., ODA securitization), more recent discussions have focused on leveraging private finance (e.g., blended finance) and sustainable investments (e.g., green bonds). Yet, as noted in the Addis Agenda, some earlier innovative instruments still have the potential to be replicated and scaled up.

3.1 Blended finance

Blended finance, which uses public funds to crowd in private finance,[48] has been used for decades, although interest in it has grown since the adoption of the Addis Agenda. This type of funding is most relevant for investments necessary for sustainable development (i.e., that have social returns), which are not attracting private investment but still have a business rationale and potential cash flows to repay the private partner. The objective is to unlock investment that the private sector would not have done on its own in support of national development priorities,[49] and do this with minimum concessionality or subsidy (i.e., just enough to make a project attractive to commercial investors).[50]

Between 2012 and 2018, total private finance mobilized by bilateral and multilateral development finance providers grew an average of 21 per cent annually, to reach $48.4 billion[51] (see chapter III.B), with DFIs reporting that $1.1 billion in concessional finance mobilized about $6 billion.[52] Of the total mobilized, 55.5 per cent targeted the energy and banking sectors, while only 5.6 per cent went to projects in social sectors (see figure III.C.10).[53]

Concessional resources have been used primarily for three purposes: (i) to mobilize private investment in infrastructure projects, either by mitigating investor's risks through public guarantees, or by providing concessional loans/grants to reduce project costs; (ii) to facilitate loans by local finance institutions to underserved segments or priority sectors, for instance via concessional loans to microfinance institutions or credit guarantee schemes; and (iii) to increase the supply of risk capital directly to firms, for example, through risk-return enhancing mechanisms such as a first loss tranche.

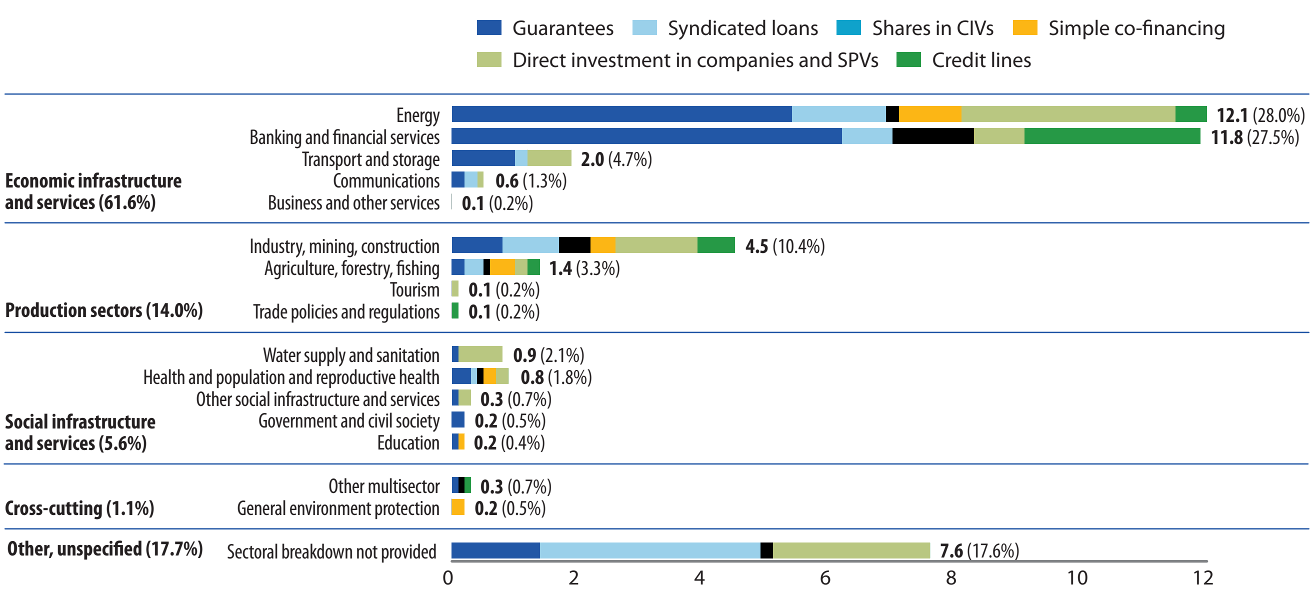
The choice of instrument depends on the sector and type of transaction, as well as country circumstances and the underlying impediments to private sector investment that blending is helping to overcome. For example, if the impediment to investment in a big infrastructure project is low expected returns, the solution might be concessional loans. If this is compounded by high risk (e.g., political or currency risk) the solution could include risk guarantees. If perceived risks by the private investor are out of line with the public sector's perceptions, guarantees could be the cheapest alternative for public entities, who would be arbitraging the difference in risk perceptions.

The Addis Agenda also calls on countries to share risk and returns fairly in blended finance. This implies that if there are deals with high upside potential, the public entity should use instruments with equity-like characteristics that allow it to share in the upside, then use those gains to fund other investment (see chapter III.B for an in-depth discussion on different instruments). Blended finance deals should also be disaster-risk informed, clearly defining the risk reducing roles and responsibilities of the public and private sector to attract sufficient private investment, while ensuring the public sector is not overly burdened by stranded assets in the event of a disaster.

Yet, even though blended finance has grown rapidly, it has largely bypassed LDCs. Approximately $9.3 billion—or 6 per cent of the $157 billion private finance mobilized between 2012 and 2017—went to LDCs.[54] Blended finance deals in LDCs also tend to mobilize less private finance. The average private finance mobilized in LDCs is $6.1 million per deal, compared to $27 million in lower-middle-income countries and $61 million in upper-middle-income countries.[55]

The low proportion of deals in LDCs (as well as in conflict and post-conflict countries[56]) highlights the fact that blended finance, like private finance, is drawn to areas with lower barriers to private capital mobilization. It can also indicate a tendency of blended finance to focus on less costly projects with lower-risk profiles, and potentially lower developmental impacts.[57]

Figure III.C.10
Amounts mobilized from the private sector by instrument and sector, 2017-2018
(Billions of United States dollars)



Source: OECD/DAC data.
Note: SPV – special purpose vehicle; CIV – collective investment vehicle.

For example, while blended finance projects have often mobilized additional finance, they have generally had only a modest impact on poverty.[58] However, even more often, the developmental impact is unknown, due to weak monitoring and reporting and poor transparency.[59]

The implication could be that, rather than trying to scale up existing types of blended finance transactions, a different approach may be needed. The approach should also be based on understanding where the impediments to investments are, before deals are entered. Integrated national financing frameworks, which include binding constraint analyses—such as the country private sector diagnostics by the International Finance Corporation (IFC)—can be helpful in this process.[60] This approach should be firmly grounded in country ownership. Projects that are aligned with national priorities and plans, and that involve local and national actors, are much more likely to have long-lasting impacts.

Box III.C.2
Principles for blended finance, extracted from the Addis Ababa Action Agenda

1. Appropriate use (i.e., financial and developmental additionality)
2. Sharing risks and rewards fairly
3. Alignment with sustainable development
4. Clear accountability mechanisms
5. Transparency
6. Participation, particularly of local communities, in decisions affecting their communities
7. Effective management, accounting, budgeting for contingent liabilities, and debt sustainability
8. Alignment with national priorities, promotion of country ownership and other relevant principles of effective development cooperation

Source: *Addis Ababa Action Agenda of the Third International Conference on Financing for Development* (Addis Ababa Action Agenda) (United Nations publication, Sales No. E.16.I.7).

Different groups of actors have defined principles for blending for their own activities, which are in line with principles put forward in the Addis Agenda (box III.C.2). These include the 2017 OECD/DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs, which were endorsed by the OECD/DAC, and the 2017 DFI Working Group Enhanced Blended Concessional Finance Principles.

Building on these principles, countries and development partners should take a six-pronged approach to blending: (i) develop a country blending strategy linked to country needs; (ii) focus on development impact (a search for impact, rather than a search for bankability); (iii) measure the cost of blending versus other financing structures; (iv) account for complementary investment; (v) provide capacity development; and (vi) ensure transparency and impact reporting, participation, and monitoring throughout the life of a project.

First, deals that include concessional finance should be *driven by country needs*. In many blended finance transactions, Governments are involved, if at all, only after the investment decision is made. Changing this could likely require countries and partners to create a space where they can agree on a framework for the usage of concessional resources for private sector projects—for example, by developing blending strategies.

Second, the primary focus of all blended deals should be *development impact* (a shift from a focus on bankability to development impact). Concessional resources should be allocated where the impact is the greatest and not where it is the easiest to make deals. The latter would inevitably result in LDCs being overlooked by blended instruments. It is easier to achieve higher leverage ratios in middle-income countries—for example, by subsidizing lending of a local finance institution rather than supporting a venture capital fund in a frontier market. Similarly, concessionality levels for infrastructure projects are likely to be much higher in LDCs than elsewhere. Development partners need to acknowledge this reality and customize blended instruments to local circumstances. DFIs also need to reflect this reality in staff internal objectives, so the focus is on delivering impact rather than volumes.

Third, analysis should always include measurement of *the cost of blending versus other financing mechanisms*. For example, the biggest infrastructure needs may be in social infrastructure or other areas that might not be profitable to private investors, even with enhancements. Water and sanitation—where commercial viability is often challenging due to equity concerns—has attracted a limited amount of private finance mobilized by official development finance (2.4 per cent of the total OECD-reported amounts mobilized from the private sector),[61] while social sectors, such as health, education and gender equality, are scarcely covered.[62] In those cases, public investments might be more appropriate, even if a complex blended deal could be arranged. Indeed, these are the types of cases where blended deals could fail or cause a public backlash when the size of the subsidy to the private partner becomes public.

Fourth, analysis should include t*he cost of complementary investments, as well as prioritization*. For example, in the case of credit constraints to domestic small and medium-sized enterprises, the public sector can offer concessional lines of credit; but if the constraint is local capacity for credit analysis, a credit line on its own will be insufficient. Instead, it should be coupled with capacity development. Similarly, the policy conclusion might be that it makes more sense to use concessional funds to first strengthen the enabling environment, rather than in investment in specific deals (see chapter III.B). Indeed, strengthening the investment environment reduces risks for investors, thus lowering the cost of finance (as opposed to blending, which shares risks between the public and private parties). In other cases, the specific investment can help strengthen the enabling environment (e.g., resilient infrastructure, or financial market investments).

Fifth, *capacity development support,* including helping countries identify and apply appropriate instruments will, in many instances, be crucial for success.

Finally, *reporting on impact and transparency* are critical both to decision-making and to monitoring and review, as is *participation of stakeholders.* Governments and engaged partners should work towards ensuring that blended finance facilities enhance the quality of monitoring, evaluation and, ultimately, sustainable development impact. There are some important efforts to address these issues. For example, the IFC announced in October 2019 that it would disclose the estimated subsidy and justification for each project as there were concerns over the way it was providing subsidies to companies under the $2.5 billion IDA Private Sector Window. For blended finance to become more standardized, effective, and sustainable, more will need to be done, in line with broader efforts to improve impact reporting.

To further efforts in blended finance, the OECD, DFI Working Group, and Indonesia and other Governments are advancing the Tri Hata Karana Roadmap for Blended Finance through five working groups covering good practices, mobilization, transparency, inclusive markets and impact.

3.2 Restructuring cash flows

In the mid-2000s, the Leading Group on Innovative Financing for Development introduced several initiatives that were based on restructuring cash flows, building on innovations in private markets. Most of these mechanisms aim to make development cooperation more effective, rather than solely raise resources (although the most recent effort—MDB securitization—raises additional resources for development). As these instruments engage in some form of what is often referred to as financial engineering, all of them also impact incentives, with some of them (e.g., advanced market commitments) designed for this purpose. The aim should be to ensure that any changes in incentives are aligned with sustainable development.

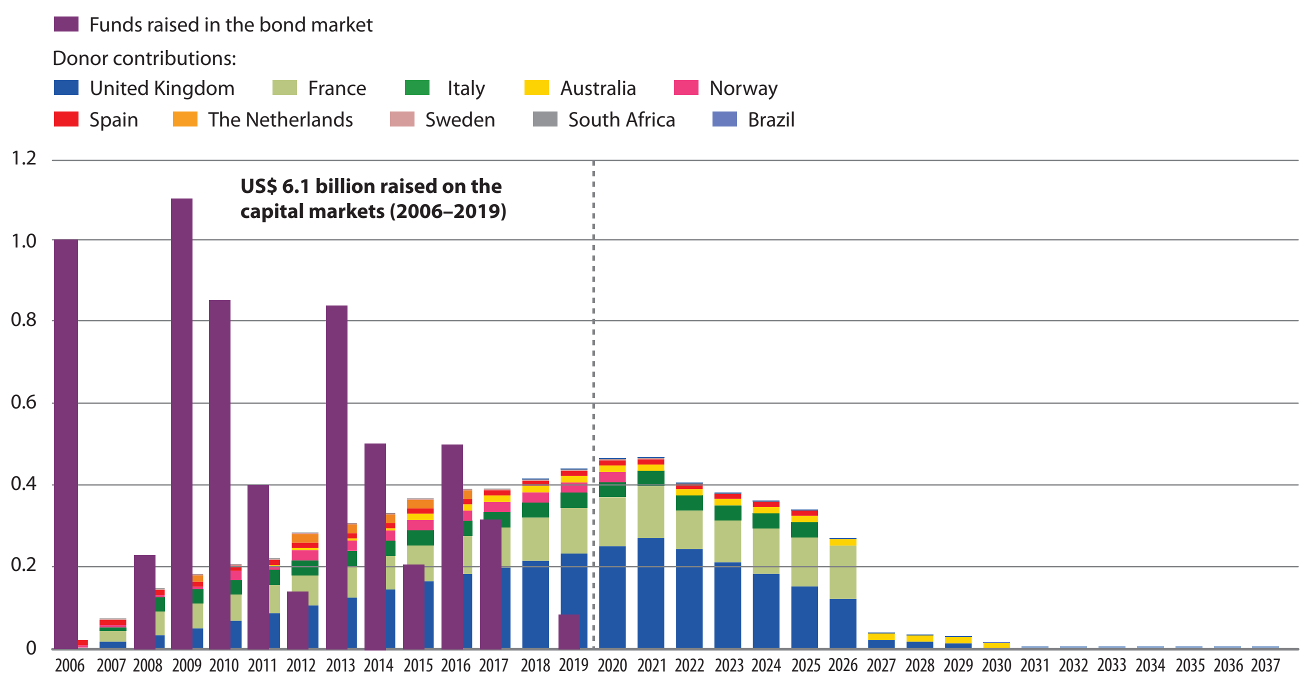
Securitization

Securitization, which converts illiquid assets into marketable securities, has been used in at least two ways in development cooperation: (i) securitization of MDB loan portfolios to increase the MDB borrowing capacity and (ii) securitization of ODA flows to support investments that have large upfront financing needs.

MDB securitization, pioneered by the AfDB (see section 2.3) responds to the Addis Ababa call for MDBs to make better use of their balance sheets. Similar to securitization in financial markets (see chapter III.B), this involves an MDB securitizing (and selling) a portion of its loan portfolio to bondholders. While the MDB gets paid upfront, future loan repayments go to repay the bondholders. The MDB offsets some of the risk of default to the bondholder, allowing the MDB to further increase its lending. Although MDB securitization does not have the same characteristics as mortgage or auto-backed securities (which are comprised of diversified portfolios of thousands of small loans), there are still potential risks to this approach. In particular, there are questions as to how a sovereign's borrowings are treated in the case of default (e.g., does the bondholder have the same incentive as the development bank to work with the borrower (who could be a sovereign) or to refinance the loan, when feasible?) (see chapter III.E). There is also a risk that MDB loan officers, who are sometimes judged by deal volume and performance, will have an incentive to lower credit standards when they know the loans will be sold to a third party.

To address these issues, the AfDB created a synthetic securitization, that is, the loans remain on the AfDB balance sheet until they reach maturity. The AfDB then passes any payment from the creditor to the bondholders. To further align incentives, the AfDB retained 10 per cent of every securitized loan. This is similar to asset-backed structures in private markets, where, following the financial crisis, issuers have been required to hold on to a portion of debt to "keep some skin in the game". In scaling up securitization structures, it will be important to learn from both the successes and

Figure III.C.11
IFFIm financing model, 2006–2019
(Billions of United States dollars, current prices)



Source: IFFIm, "Donors," 2019.

challenges of early experiences, including setting the appropriate retention percentage.

In ODA securitization, future ODA commitments are securitized into tradable bonds to fund development needs today. The financing model of the Global Alliance for Vaccines and Immunization (Gavi) provides the most successful example of securitization of ODA commitments. [63] The Gavi International Finance Facility for Immunization (IFFIm) raised $6.1 billion through offerings on vaccine bonds in the capital markets between 2006 and 2019 (figure III.C.11).[64] Rather than making annual ODA payments to the Government, 10 sovereign sponsors used their ODA annual commitments to repay the bondholders. While this financing model does not provide additional resources, it front-loads future payments. The nature of immunization campaigns provides a strong rationale for front-loading resources, as immunization campaigns need to reach a threshold level of immunization rates (between 75 and 95 per cent)[65] to effectively curb the transmission of the disease.[66]

Although the Addis Agenda encouraged the replication of instruments such as IFFIm, there has not been much success in this area. In part, this reflects challenges associated with creating IFFIm-type structures, which require legally binding, multi-year aid commitments from donors, which some donors find difficult to accommodate in their budget systems; commitments are normally recorded when they are made rather than when they are due. Yet, the successful example of IFFIm shows that this is possible. In the context of the 2030 Agenda, this type of structure could be useful in areas that need front-loading, such as large infrastructure investments, potentially as part of blended finance deals.

Advance market commitments

Advance market commitment (AMC) is another innovation that was pioneered in the health sector in the 2000s. Pharmaceutical companies do not necessarily have incentives to develop drugs for diseases that are predominant in developing countries, where many people cannot afford to buy the drugs. In AMCs, donors agree in advance to purchase drugs at a predetermined price, thus guaranteeing a market, and incentivizing the drugs' development.

The pilot AMC was established in 2009 for pneumococcal vaccines, with donors agreeing to $1.5 billion in long-term purchase commitments to encourage the development and production of affordable vaccines tailored to the needs of developing countries.[67] The programme proved to be extremely successful, with 59 countries introducing pneumococcal vaccines.

Despite this success, AMCs have not replicated in other contexts. This could be due to potentially high research and development (R&D) costs and uncertainty fulfilling product specifications once developed.[68] The pneumococcal vaccine, for example, was already in late stages of development in 2003, before the initiation of the AMC. Others have also argued that AMCs favour large multinationals over disease researchers at non-profit and public research organizations, and that AMCs buy vaccines already developed rather than accelerate research.[69] Nonetheless, AMCs remain an option to spur R&D, and could be explored in areas of new technologies, for example, in digitalization, agriculture, and water scarcity.[70]

3.3 Instruments for risk management

Risk pooling instruments are one of several options, which can be part of a broader risk reduction financing strategy. Institutional pooled funds and insurance-like instruments can play complementary roles; and greater provision of international resources to both types of instruments could bring benefits and greater efficiency compared to the current practice of ex post disaster response.

Catastrophe risk pooling

International risk pooling, whether in multiple-country insurance, loans, or grant facilities, is an advantage of international cooperation. By grouping together well-diversified risks into a single risk pool, the cost of insurance (and thus the premiums that participants pay) can be reduced. While the resources provided by insurance after a disaster are not sufficient to address all economic losses, they can provide quick financing for emergency response and be designed to align incentives for disaster risk reduction.

Since 2007, 32 countries, many of which are SIDS, have joined catastrophe risk pools in three regions through the Caribbean Catastrophe Risk

Table III.C.1
Regional sovereign insurance pools

Regional pool (established)	*Hazards insured*	*Member States/territories*	*Premium, coverage, pay-out*
CCRIF (2007)	Earthquake, tropical cyclone (hurricanes), excess rainfall, drought	Insured members (21), other eligible members (14)	Source of premiums: credits from IDA and the Caribbean Development Bank Average premium: $21.5m Average coverage: $650m Average coverage: $650m
PCRAFI (2013)	Tropical cyclone, earthquake/tsunami, excess rainfall	Insured members (3), other eligible members (12)	Source of premiums: grants, national budgets, IDA credits Average premium: $2m Average coverage: $45m Cumulative payout: $3.2m
ARC (2013)	Drought, extreme weather (drought, excess rainfall, heatwaves and tropical cyclones)	Insured members (6), other eligible members (6)	Source of premiums: national budgets, grants Average premium: $22m Average coverage: $50m Cumulative payout: $34m
SEADRIF (2018)	Mainly flood risk	Signatories to agreement (6)	To be determined

Source: Cebotari and Youssef, "Natural Disaster Insurance for Sovereigns" (2020); World Bank, "Sovereign Climate and Disaster Risk Pooling, World Bank Technical Contribution to the G20" (2020).

Insurance Facility (CCRIF), the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI), and the African Risk Capacity (ARC), while a fourth pool is in the process of being set up (Southeast Asia Disaster Risk Insurance Facility (SEADRIF). These pools have relied on development partners for technical and financing capacity, including donor funds for start-up costs, capitalization, and premium financing (through grants and the use of concessional lending instruments, such as from IDA and the Caribbean Development Bank (CDB))[71] (Table III.C.1).

For insurance to be most effective, sufficient numbers of participants with different risk profiles are required. As not all countries are able to afford the necessary insurance premiums, especially LDCs, donor support could boost participation in the insurance scheme, which would support individual countries while further diversifying risks and increasing efficiency. For example, premiums for the first pilot season for PACRAFI were fully covered by grants, while countries made partial premium payments in the second season.[72]

The regional nature of these pools also constrains their diversification, given that hazards often impact several countries in a region together. One solution would be to set up a global risk facility. Alternatively, strengthened public or private reinsurance could further diversify risks across the regional funds. This would require further enhancement of regional facilities and insuring diverse participation in the regional pools.

Technological advancement is also helping to better predict events and more effectively price insurance (see chapter III.B). However, improved predictions can also lead to effectively excluding countries and regions with the highest risk, underscoring the importance of the use of development cooperation to ensure that no one is left behind. Yet, given the rapidly changing landscape caused by climate change, it is also important to address narrowly defined triggers. Because they are based on big data that inherently compiles past events, they might need to be adjusted to be broad enough to protect countries against related risks (similar to the pandemic bond described below).

Additional mechanisms for addressing catastrophes

Catastrophe bonds (CAT bonds) enable sponsors to transfer catastrophe risk to capital market investors through a special purpose vehicle that provides protection like an insurance policy. [73] Since 2014, the World Bank has issued several catastrophe bonds, including a pandemic bond of $425 million in 2017[74] and a $1.36 billion multi-country earthquake bond in 2018—the Pacific Alliance countries (Colombia, Chile, Mexico and Peru) CAT bond.[75]

In these bonds, Governments pay a premium (e.g., a coupon to the bondholders) in exchange for protection in the case of disasters. Donors can help with premium payments—such as for IDA countries in the case of the pandemic bond—while simultaneous issuance—such as for the Pacific Alliance countries CAT bond—provides diversification for investors, as well as economies of scale and pricing advantages for issuers.[76] In addition, as the World Bank issues these bonds, they do not contribute to countries' debt.

As with insurance, setting triggers so that the bonds deliver when needed, while providing the returns that investors demand, is difficult. For example, following the Ebola crisis in 2014, the Pandemic Emergency Financing Facility (PEF), a parametric-based insurance programme funded by the pandemic bond, was designed to disburse funding quickly to stop outbreaks of dangerous diseases. However, the PEF was not triggered during the Ebola outbreak in the Democratic Republic of the Congo in 2018, the second worst outbreak on record.[77] The coronavirus has raised similar questions of whether existing mechanisms will be triggered, as well as of adequacy. [78]

Another mechanism, the World Bank's "Catastrophe Deferred Drawdown Option," is a contingent line of credit that provides immediate liquidity to countries upon the declaration of a state of emergency in the aftermath of a disaster. Countries need to be preapproved based on a disaster risk management programme and macroeconomic framework.[79]

3.4 Pooled funds

A related innovation in development cooperation is funds that pool public and private resources for a specific issue or theme. To date, these funds have been used primarily for health- and climate-related international and global public goods.[80] These funds link funding and visible outcomes (results focused), are transparent and appeal to development partners and the public through clear goals.[81] They can also attract private donors and are a major mechanism for philanthropic flows, such as the Bill and Melinda Gates Foundation (BMGF).

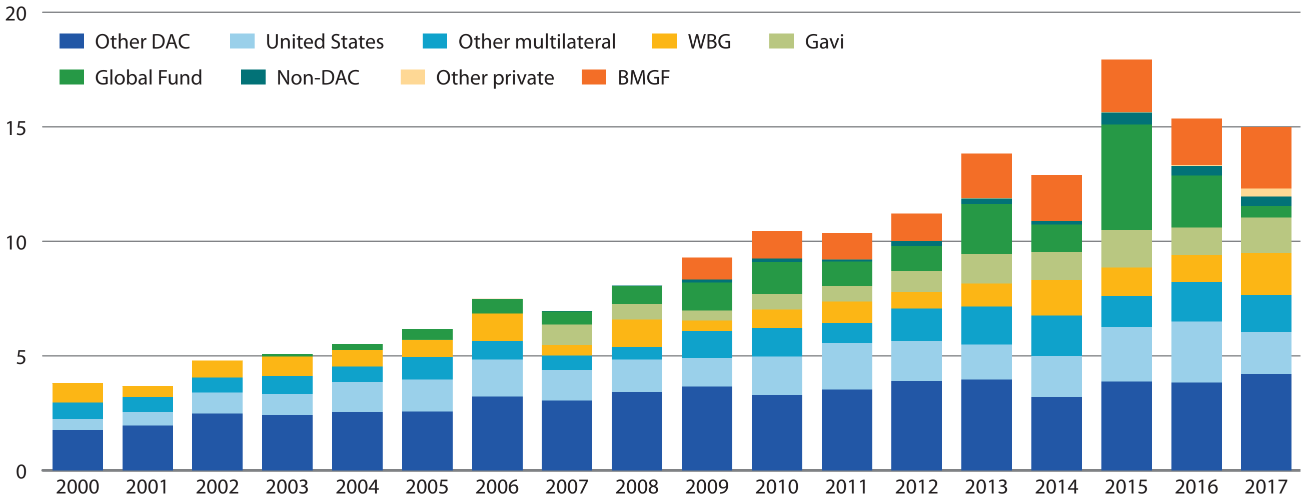
In the health sector, the Global Fund for AIDS, Tuberculosis and Malaria (Global Fund) and Gavi accounted for almost a quarter of total ODA for health between 2015 and 2017 (figure III.C.12). In 2019, the Global Fund was replenished by $14.02 billion for the 2020-2022 period,[82] while Gavi is seeking a replenishment of at least $7.4 billion in 2020 for the 2021-2025 period.[83]

In the climate space, there is a proliferation of funds.[84] The UNFCCC has several dedicated climate funds, including the GCF, the Adaptation Fund, the Global Environment Facility (GEF), the LDC Fund and Special Climate Change Fund. Outside the UNFCCC financial mechanism, there are many climate-related funds managed by various United Nations agencies and MDBs.

Despite their success in mobilizing resources, global funds are criticized for contributing to the fragmentation of the aid architecture.[85] These issues are quite apparent in the complex climate finance architecture, given the numerous funds, different implementing agencies, and bureaucratic processes, which make it difficult for countries, especially LDCs and SIDS, to access climate funds.

These funds are strongest when they can help build capacity in countries that is sustained over the longer term. New funds are often proposed across sectors (e.g., see chapter IV for a proposed fund to build statistical capacity). Before establishing a fund, the benefit of pooling should be clear. Will it be more transparent and/or accountable? Can it attract additional funds from philanthropy and/or raise greater donor interest? How does it fit in with country plans, and are benefits transferred to the country level? Are there benefits in terms of capacity development? Ensuring complementarity, transparency, accountability and streamlined administrative processes should be key elements in the design and implementation of any new funds.

Figure III.C.12
Funding to the health sector by donor, 2000-2017
(Billions of United States dollars, 2017 constant prices)



Source: OECD/DAC data.

3.5 Additional mechanisms to raise new resources for development cooperation

Solidarity taxes

Coordinated internationally but implemented nationally, a solidarity tax is levied to provide funding towards a public good. Solidarity taxes (e.g., carbon taxes) are often designed to also impact incentives.

The most successful international solidarity tax, a levy on airline tickets pioneered and implemented by France, and currently also applied by two other countries, funds UNITAID, a global health initiative that invests in innovations to prevent, diagnose and treat HIV/AIDS, tuberculosis and malaria. Between 2006 and 2018, 62 per cent of the $3.1 billion contributions to UNITAID came from air ticket levies.[86]

A second initiative, UNITLIFE, was launched in 2015 to help finance the fight against malnutrition in sub-Saharan Africa. Initial plans for the initiative to be funded by a micro-levy on the extractive industries were not successful,[87] and it is now looking to be funded through micro or small donations through digital platforms.[88]

Proposals for a financial transaction tax (FTT)—a tiny tax on transactions, such as equity trades, bonds, currencies or derivatives—to finance development have also not materialized. Many countries have imposed FTTs for domestic resource mobilization purposes but generally do not earmark proceeds for international development.[89]

Innovative bonds instruments

Green bonds and similar instruments, such as SDGs-linked bonds, have grown significantly since the EIB and the World bank issued the first green bonds in 2007-2008. The World Bank was also the first to issue an SDGs bond in 2017. MDB issuance of such bonds helped to build a broader green bond market. MDBs and development partners have also supported government issuance (e.g., the Seychelle's "blue bond") to support sustainable marine and fisheries projects.[90] (A discussion of green bonds and related instruments can be found in chapter III.B.)

4. Graduation and access to concessional finance

As developing countries graduate to higher income per capita status, access to grants and concessional finance windows declines. Terms of finance can become more expensive, including both higher borrowing costs and shorter maturities. The situation is particularly challenging for those graduates that are highly vulnerable to external shocks and disasters, especially extreme weather events, which can cause countries' development prospects to backslide.[91]

4.1 Impact of graduation

In the context of international development cooperation, "graduation" can refer to three separate events: graduation from multilateral concessional assistance, from LDC status, and from ODA eligibility. A key determining factor of all three contexts is a country's per capita income, although other factors are also considered (see table III.C.2). Graduation from multilateral concessional assistance, particularly the concessional windows at MDBs, is based primarily on per capita income, along with creditworthiness. Graduation from LDC status is based on income per capita, vulnerability and the level of human assets. Graduation from ODA eligibility is based on income per capita alone. Countries' access to concessional finance from bilateral providers and some global funds may also be impacted as income per capita rises.

Impact of income graduation

Recent research indicates that despite the loss of access to some sources of concessional finance, reaching middle-income status does not necessarily result in a decline in ODA.[92] In fact, ODA generally increases when countries' per capita income rises above the low-income threshold, and only falls when countries reach upper-middle-income or high-income country levels.

Nonetheless, ODA falls as a percentage of gross domestic product (GDP) as countries' incomes grow. Even though tax revenues rise in per capita terms, total public finance as a percentage of GDP declines—the so-called "missing middle" challenge.[93] The evidence on the depth and breadth of this challenge is mixed in this area, with some countries experiencing this problem, while others appear to have overcome it.[94] Those countries that were able to overcome the financing gap generally did so over time; tax revenues did not necessarily increase consistently, and there were periods when tax revenue and ODA both fell. For some countries, it took tax revenues more than 10 years to rise sufficiently to offset the decline in concessional finance relative to GDP.[95] In addition, countries faced higher interest rates and shorter maturities on new borrowing,[96] and almost a quarter faced debt sustainability issues.[97]

Table III.C.2
Major multilateral concessional assistance

Multilaterals	Concessional Instruments	Type	Eligibility criteria	Transition Phase	Graduation criteria	Reverse Graduation
European Institutions	European Development Fund	Grants	A African, Caribbean and Pacific countries, European Union overseas countries and territories	-	-	-
IMF	Extended/Standby/ Rapid Credit Facilities	Loans	Low income countries (LICs) (GNI per capita <$1,025)	-	Non-LICs (GNI per capita >$1,025)	-
MDBs: World Bank	IDA	Grants, Loans	GNI per capita <$1,175 (cut-off), insufficient creditworthiness, with small economy exception[a] (*IDA-only countries)*	*Blend countries*: below cut-off and creditworthy for International Bank for Reconstruction and Development (IBRD) *Gap countries*: above cut-off for 2 years but not creditworthy for IBRD.	GNI per capita >$1,175 and creditworthy (*IBRD-only countries*)	Yes
MDBs: Regional development banks: AfDB	African Development Fund (AfDF)	Grants, Loans	GNI per capita <$1,175 (cut-off), insufficient creditworthiness (*AfDF countries*)	*Gap countries*: meets cut-off but not creditworthy; *Blend countries*: below cut-off but creditworthy; *Graduating countries*: above cut-off and creditworthy[b]	GNI per capita above >$1,175 and creditworthy (*AfDB countries*)	Yes
MDBs: Regional development banks: ADB	Asian Development Fund	Grants	GNI per capita <$1,175 (cut-off) or LDC, insufficient creditworthiness, level of debt distress (*Group A grants-only, AsDF blend and COL countries*)	*Group B OCR blend countries*: below cut-off or LDC with limited creditworthiness; or above cut-off with limited creditworthiness	GNI per capita >$1,925 and creditworthy (*Group C Regular OCR countries*)	Not specified
	Concessional Ordinary Capital Resources (OCR) Lending (COL)	Loans				
MDBs: Regional development banks: IDB	IDB Grant Facility	Grants	GNI per capita <$2,919 (cut-off) and/or insufficient creditworthiness (*Group D2 countries*) [c]	Above cut-off but less than 2 consecutive years and/or lack of creditworthiness	GNI per capita >$2,919 and/or creditworthiness	Not specified
	Concessional Financing	Loans				
Global health funds: Global fund	Global Fund to fight HIV AIDS, tuberculosis and malaria	Grants	LICs and middle-income countries (MICs) (GNI per capita ≤$12,375), disease burden indicators for HIV (health), tuberculosis and malaria[d]	Lower-middle-income countries with low/moderate disease burden and upper-middle-income countries projected to transition within 10 years focus on transition preparedness. Once ineligible, up to 3 years of transition funding is provided.	High income country status, upper-middle-income countries with low or moderate disease burden	Yes
Global health funds: Gavi	Global alliance for vaccines and immunization	Grants	GNI per capita ≤$1,580 over the past 3 years (cut-off) (*Gavi-eligible countries*)	*Phase 1 countries*: above LIC threshold but below cut-off[e]; *Phase 2 countries*: above cut-off[f]	Above cut-off and no longer receiving Gavi support (*Phase 3 countries*)	Yes

Source*:* UN DESA, compiled from reports by multilaterals.
Note: a A "small island exception" (SIE) has been in place since 1985, which accords terms enjoyed by IDA-only countries to small island economies (islands with populations less than 1.5 million) that would otherwise not have qualified. In 2017, this was extended to all IDA-eligible small States (countries with populations less than 1.5 million) for the eighteenth replenishment of IDA resources (IDA18). In 2019, the SIE was further extended to IBRD-only small islands if their per capita income was below the IBRD graduation threshold (Graduation Discussion Income), were highly vulnerable to disasters and climate change, had limited creditworthiness for accessing commercial credit, and access to IBRD was constrained by creditworthiness or affordability considerations (ability to borrow non-concessional resources sustainably).
b Graduating countries are still eligible for AfDF loans, but at hardened terms during a 2- to 5-year phasing-out period.
c Of the countries in Group D2 (Guyana, Honduras, Nicaragua and Haiti), only Haiti is eligible for grants.
d LICs and lower-middle-income countries are eligible regardless of disease burden. Upper-middle-income countries are eligible if disease burden is met. Upper-middle-income countries that receive IDA under the SIE are eligible regardless of disease burden.
e Countries remain in Phase 1 for 2 more years if above cut-off but experienced more than 30 per cent single-year increase in GNI per capita in the previous 5 years or experienced a more than 20 per cent single-year increase in GNI per capita in the previous 5 years and have less than 90 per cent coverage for a certain pentavalent vaccine.
f Transition assessments are completed as early as feasible during Phase 1 and 2-3 years before projected date for entering Phase 2.

Once countries reach upper-middle-income and high-income levels, they are generally in better positions to withstand declines in ODA, as many have been less dependent on aid for a longer period and their economies have developed considerably since graduation from low-income status.[98]

Impact of graduation from multilateral concessional assistance: the case of IDA graduation

To date, 44 countries have graduated from IDA, the majority of which graduated in the 1970s. Twelve countries have reverse graduated (i.e., they have re-gained access to IDA), with three eventually graduating a second time and nine maintaining access to IDA.[99]

IDA graduation is an important and highly visible signal,[100] influencing the action of other donors, [101] including other MDBs whose instruments are closely aligned to IDA graduation criteria (see table III.C.2). A multi-stage graduation process is triggered when per capita income exceeds an operational cut-off, currently $1,175, at which point a country is no longer eligible for IDA grants. Once a country is assessed as being IBRD creditworthy (based on political risk, debt burdens, growth prospects and other factors), IBRD financing is phased in. The process typically takes multiple years and is accompanied by a graduation task force that aims to ensure a smooth path of transition. IDA graduates continued receiving ODA well after graduation, albeit with more expensive terms of finance.[102]

IDA graduation and transition policy was recently reviewed and strengthened to provide better transitional support to IDA graduates.[103] The small island exception, which has been in place since 1985, allows small island economies (populations less than 1.5 million) continued access to IDA. In 2017, this was extended to IDA-eligible small States, which benefited Bhutan, Djibouti, Guyana and Timor-Leste. In 2019, this was further extended to IBRD-only small island economies based on income, vulnerability and creditworthiness criteria, which benefited Fiji. An exceptional allowance was also made to Jordan and Lebanon, in response to the Syrian refugee crisis.[104] The World Bank is also exploring providing recent IDA graduates access to the IDA Crisis Response Window (CRW) and regional programme during IDA19. These windows provide additional resources to help eligible countries respond to severe economic crises, as well as major humanitarian and climatic disasters.

Impact of LDC graduation

To date, five countries have graduated from LDC status: Botswana (1994), Cabo Verde (2007), Maldives (2011), Samoa (2014) and Equatorial Guinea (2017). LDCs are generally not explicitly targeted for multilateral concessional assistance. Exceptions are the ADB and the European Development Fund, which prioritizes LDCs (see table III.C.2). LDCs also have access to the Least Developed Country Fund (LDCF) managed by the GEF, which was set up in 2001 to support LDCs in climate change adaptation.

Although some bilateral donors tend to prioritize their support towards LDCs, LDC graduation has not generally had a direct impact on concessional financing flows. However, as countries increased their non-concessional borrowing, the overall terms of finance became more expensive.[105] The impact of LDC graduation on trade, however, can be more pronounced, affecting 3-4 per cent of their merchandise export revenues, due to the loss of preferential market access, such as from the European Union (EU) Everything But Arms initiative and Generalized System of Preferences.[106]

The LDC graduation process generally takes at least six years. Most graduating LDCs had already reached the upper end of middle-income status at the time of graduation. Of all the LDC graduates, Cabo Verde is the only country whose per capita income remained on the lower end of middle-income status both pre- and post-graduation. There is also growing engagement with non-DAC donors, who also provide non-concessional finance after graduation.[107]

LDC graduation can be triggered if any two of the three criteria (income per capita, human assets and vulnerability) are met. In most cases, the vulnerability threshold is unmet. For example, Maldives had to recover/rebuild from a devastating tsunami prior to graduation, underscoring the risks faced by SIDS and countries particularly vulnerable to disasters. Some LDC-specific support measures are extended for a limited time to ensure smooth transition. For example, the LDC Fund can support projects that were approved pre-graduation.[108] However, for LDC graduates that lose priority access to the GCF, they do not currently have any specific transition support.

Impact of graduation from the global health funds

Graduation from the global health funds is tied to a country's income level and are generally targeted to low- and lower-middle-income countries, although upper-middle-income countries have access to the Global Fund depending on disease burden (see table III.C.2). At the end of 2019, nine countries had graduated from the Global Fund,[109] while 19 countries have graduated from Gavi.[110]

Both health funds have made efforts to review and update their eligibility, transition and graduation policies to account for the challenges that countries face with graduation, including allowing for reverse graduation.[111] Co-financing requirements that gradually increase with income per capita also support countries' transition out of support. However, although countries are expected to make up for the loss in concessional funds from public budgets, the reallocation to replace donor funding was relatively minimal (less than 1 per cent of GDP).[112]

For the global health graduates, a major concern is the simultaneous graduation of countries from several global health funds,[113] as well as from IDA (e.g., Cameroon, Nigeria and Pakistan) and LDC status (e.g., Sao Tome and Principe). This underscores the need for a coordinated approach and system-wide perspective to graduation plans, aligned with health sector strategies on universal health coverage.[114]

Impact of ODA graduation

When a country graduates from the DAC ODA list, aid it receives is not reported in official ODA statistics. However, ODA graduates can and do receive concessional support, albeit to varying degrees. EU members still receive grants from the EU through the Cohesion Fund.[115] Barbados and Trinidad and Tobago have also received grants under the European Development Fund.[116] These exceptions are indications that ODA graduates may still require support, despite reaching a higher level of income per capita, underscoring that the level of development is not necessarily synonymous with the level of income, as development is a complex, continuous process that can be reversible.[117]

The challenges faced by countries transitioning to upper-middle-income or high-income status and graduating from ODA have led some providers to rethink international cooperation, moving from graduation to gradation.[118]

This means that allocation of concessional finance would still decline as countries become wealthier, but middle-income countries would be eligible for financing for specific projects/sectors, such as regional or global public goods, possibly with differentiated financing options that reflect country contexts and project characteristics. In 2018, the EU set up a Regional Facility for Development in Transition for Latin America and the Caribbean to assist countries in their transition process. The OECD/DAC also recently agreed to a process of reverse graduation, prompted by challenges countries faced due to climatic events. There are also suggestions for countries and development partners to develop a strategy of cooperation beyond ODA, including technical assistance, regional, and triangular cooperation.[119]

4.2 Addressing vulnerability and building resilience

The impact of the increased frequency and intensity of climatic events and other hazards can set back years of progress for some graduating countries. Member States of the United Nations have invited development partners to use LDC indicators, including vulnerability, as criteria for allocating donor support.[120]

ODA providers have generally been responsive to graduates' vulnerability to climatic events (and conflict/political instability), albeit in a reactive way. A more proactive and systematic approach in transition support to deal with vulnerability and building the resilience of all graduates can smooth the transition process and help more countries achieve the SDGs.

SIDS are considered some of the most vulnerable countries, particularly to natural disasters and climate change,[121] and are sensitive to the impact of graduation in all contexts.[122] The majority of SIDS are upper-middle-income countries: seven have graduated from ODA, with two more expected to graduate by 2021. Exceptional and targeted concessional support for SIDS has been crucial in their smooth transitions.

As noted, IDA and several regional development banks' concessional facilities include exceptions that allow small island developing States to access concessional funding even if they exceed income thresholds. The World Bank recently used vulnerability criteria among other indicators to extend its IDA small economy exception and is also considering opening access to the CRW to recent IDA graduates.[123] SIDS that have graduated from ODA also continue to access the European Development Fund, which uses an economic vulnerability index in its country allocations formula.[124] Spurred by the major hurricanes that hit several Caribbean islands in 2017, the OECD/DAC agreed to rules that would make it possible for countries to become reinstated for ODA eligibility if their per capita income fell back below the World Bank's high-income threshold for one year. However, the DAC continues to negotiate an agreement on a process to allow temporary access to countries following a catastrophic humanitarian event.

The graduation process is also an opportunity to strengthen support to countries on disaster risk reduction. Graduating countries should have disaster risk reduction strategies in place, supported by disaster risk reduction financing strategies that inform integrated national financing frameworks (INFFs).

4.3 Lessons from graduation experiences

There are several lessons from graduation experiences. First, prior conditions matter. The successful transitioning away from concessional facilities is linked to country circumstances at the time of graduation (macroeconomic, debt levels and fiscal space, poverty and social conditions, etc.). A related factor is a country's ability to tap capital markets, along with the cost of capital and the non-financial terms of the debt (which are based on the country's credit quality and rating). A country's reliance on concessional funding prior to graduation also matters.[125] Second, vulnerability to economic, political, climatic shocks and other hazards can derail successful graduation. Flexibility in transition processes can help countries in these situations. Third, relationships with partners remain important post-graduation.[126]

Graduation strategies

These lessons inform strategies for graduating countries and partners: First, planning prior to graduation is needed to ensure a holistic and pragmatic approach to transition. Simultaneous graduations underscore the need to plan the sequence and magnitude of the different elements of graduation. This requires a coordinated approach and system-wide perspective. It includes a disaster risk strategy and investing in appropriate infrastructure. INFFs,[127] including using the OECD transition finance toolkit,[128] can help link financing to development/transition strategies and uncover gaps that require transition support.

Second, capacity development prior to graduation is important across sectors. It should be targeted at areas where financing and programmatic gaps might be most critical. This varies by country but would often include strengthening domestic resource mobilization; public financial and debt management; financing for disaster risk reduction; and strengthening governance and institutional capacity, including the enabling business environment for private investment. Countries may benefit from non-traditional modalities of support and technical assistance, including through peer learning, South-South cooperation and triangular cooperation.

Third, development partners should continue to build in flexibilities to reflect country vulnerabilities. Many of the graduation processes now have flexible, multi-stage transition processes in place. Continued pragmatic policy responses and support is important to benefit graduates, particularly more vulnerable lower-middle-income countries. Reverse graduation processes are also needed for those countries facing difficulty transitioning.

Flexible approaches and exceptional support, on a case-by-case basis, have also assisted struggling ODA graduates. However, many in this category have coped better than others during transition, and support for ODA graduates should not be at the expense of support for LDCs and other vulnerable countries.

Fourth, cooperation with development partners as countries go through the graduation process remains important. It includes expanding technical assistance, accessing non-concessional instruments from MDBs, and leveraging regional programmes and triangular cooperation.

5. Quality, impact and effectiveness of development cooperation

5.1 Development coordination and cooperation

Country ownership, which remains central to the impact and effectiveness of development cooperation, begins with the establishment of strong national development plans. Governments have made significant progress in this area since the start of the decade, including the integration of the 2030 Agenda. Since 2011, the proportion of partner countries with national development strategies assessed as high-quality has almost doubled, from 36 to 63 per cent. Nearly all strategies (90 per cent) approved from 2015 onward reference the 2030 Agenda and/or the SDGs, and developing-country Governments are consulting a broad range of national stakeholders in the design of their plans. Nonetheless, as noted in the *Financing for Sustainable Development Report 2019*, most national strategies do not spell out in detail how they will be financed. Only 73 per cent of partner countries link development strategies with resources needed for implementation. [129]

Integrated national financing frameworks, as called for by the Addis Agenda, are a tool that can help link financing to development strategies, and strengthen countries' planning processes and country ownership. National development cooperation policies can help mobilize and align international development cooperation with their country priorities within an INFF. Preliminary results from the 2020 Development Cooperation Forum Survey indicate that almost two thirds of countries surveyed had a national development cooperation policy or similar strategy in place.

As countries establish INFFs, associated shifts are likely needed in coordination structures and mutual accountability mechanisms to consider more diverse finance sources and a plurality of partners. Access to reliable information on development finance is important for effective development planning and budgeting, as well as accountability, as maintained through parliamentary oversight. However, most countries currently lack capacity to monitor implementation with only 35 per cent of Governments having data and systems to track implementation of national strategies. A recent survey also indicates that the share of development finance subject to parliamentary scrutiny has fallen.[130]

Despite considerable strengthening in developing countries' planning processes, development partners' alignment to country priorities and country-owned results frameworks is declining.[131] In 2018, while 83 per cent of new projects have objectives aligned to country priorities, only 59 per cent of results indicators are drawn from country-owned results frameworks, and only 50 per cent align with their statistics and monitoring systems. Countries also report that medium-term predictability is declining, with limited provision of forward expenditure and implementation plans by development partners.[132]

While developing-country Governments have strengthened their public financial management systems, including through gender budgeting, development partners increased their use only marginally: in 2018, 53 per cent of development cooperation disbursements to the public sector used country systems, compared to 49 per cent in 2010.

In addition, while the share of untied ODA increased from 81 per cent in 2015 to 82 per cent in 2018, progress has been uneven across development partners and is not reaching all partner countries. Moreover, ODA is not fully untied in practice, with contracts being largely awarded to companies based in DAC countries.[133]

5.2 Multi-stakeholder partnerships

Effective multi-stakeholder partnerships can support implementation of the SDGs, including through INFFs, by bringing together different sectors, approaches (public service mandate, people focused or market based), and complementary resources (technological, human, social or economic).[134] One challenge is to ensure civil society organization (CSO) participation, which often faces capacity limitations, as well as limits on inclusiveness. [135] Concerted action by developing countries and development partners can support CSOs as equal partners, bringing knowledge of local development needs and priorities.

The growing interest within the development cooperation community to partner with the private sector to deliver better development solutions places greater focus on the effectiveness and development impact of such engagements (see discussion in section 3.1). The Kampala Principles are a collective effort to promote country ownership, a focus on results and targeted impact, inclusive dialogue, learning, and scaling up successes, as well as recognizing and sharing risks among all partners to ensure greater impact on those furthest behind first.[136]

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