

FINANCING THE 2030 AGENDA

An Introductory Guidebook
for UNDP Country Offices



Disclaimer

The views and recommendations made in this guidebook are those of the authors and do not necessarily represent those of the United Nations Development Programme or Member States.

Cover photo: UN Photo Victoria Hazou

RwandBatt is working with the local community on a "Umuganda" ["Shared Work"] project, constructing a new primary school for the students in Kapuri.



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January 2018

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Introduction

How to finance the 2030 Agenda at the country level has emerged as a key issue since world leaders adopted the Sustainable Development Goals (SDGs) in September 2015. Governments' abilities to mobilize, sequence and make effective use of a wide variety of both financing *sources* and financing *instruments* and *strategies* will be central to their ability to achieve the ambitious new sustainable development agenda. This is reflected in SDG 17, "strengthen the means of implementation and revitalize the global partnership for sustainable development" which tasks countries to strengthen domestic resource mobilization, meet aid commitments and mobilize additional financial resources for development from multiple sources.¹

As a longstanding and trusted multilateral development partner to over 170 countries and territories worldwide, and with a robust track record in areas such as support for public financial management, aid coordination and environmental finance, many countries want to know how UNDP – and the UN development system as a whole – can support them to finance the SDGs.

This guidebook responds to increased country-level demand for support on financing the 2030 Agenda. It is intended to be an "entry point" for advice and information on financing for sustainable development, and the tools and services that UNDP offers in this space.

This guidebook is organized as follows:

1. Part 1 "**The Global Context:**" provides an overview of current and recent trends in financing for development and explores their implications for the financing of the 2030 Agenda;
2. Part 2 looks at some of the key ways in which UNDP can provide **country level support** on financing for development;
3. Part 3 details **UNDP's current portfolio of work on financing for development**, and provides information on the **tools and services** we provide, and where to source more information;
4. Part 4 "**Financing Solutions in Focus**" describes some of the most widely-used financial instruments as well as innovative finance mechanisms and looks at their pros and cons.

¹ For further information on SDG 17, see: <https://sustainabledevelopment.un.org/sdg17>



Feedback is welcome on how to improve this guidebook so we can ensure it remains as relevant and up-to-date as possible.²

The guidebook is complemented by a UNDP website, “**Financing Solutions for Sustainable Development**”. The on-line platform features instruments such as blended finance, development impact bonds, green bonds, trust funds, challenge funds, guarantees, impact investment, and many more. It describes each instrument’s potential, feasibility, advantages, disadvantages, risks and characteristics. It also profiles case studies and refers to multiple external sources, including e-learning and advanced guidance material, where available. It aims to provide UN country teams and other stakeholders with detailed and up-to-date information to enable them to review and operationalize the most appropriate financing solutions and strategies for each country.

Financing Solutions for Sustainable Development: UNDP on-line tool-kit

Accessible at: <http://www.undp.org/content/sdfinance/>

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**PART
ONE**



**Financing for
Development:
the Global
Context**



A Dynamic Development Financing Landscape

Introduction

Meeting the 2030 Agenda will require *unprecedented* investments in areas such as health and education, environmental protection, infrastructure and sustainable energy, rural development, peace and security and actions to tackle climate change. Every dollar will also need to be used *effectively* in support of sustainable development, and in particular reach those communities and peoples furthest behind. While financing needs for the new agenda are unquestionably high, there are also more opportunities for countries to mobilize new and additional sources of finance (public and private, domestic and international) as well as experiment with innovative new financing approaches.

The development financing landscape is dynamic and constantly changing. Many countries are now able to mobilize more domestic resources for development. Foreign direct investment (FDI) flows are on the rise combined with increased capacities to leverage finance from domestic and international capital markets. New development partners, development finance institutions, public-private 'single issue' vertical funds, philanthropic organizations and private 'impact' investors have also emerged or expanded their activities in recent years and now work actively alongside traditional donors, such as United Nations' development agencies. These new *sources* of finance and expertise increasingly complement traditional development cooperation and create opportunities for new partnerships and collaborations which can leverage the finance, expertise and networks of each partner.

This is combined with increased diversity and sophistication in financial *instruments* or the "financing tool-box". Financing is being used in increasingly sophisticated and creative ways to meet public policy objectives. Examples include: 'blended' finance (where concessional public finance is blended with non-concessional public or private finance); green and blue bonds (where bonds are issued on domestic and international capital markets for the financing of environmentally-sound infrastructure); lending in local currencies and to sub-national authorities; Islamic financing instruments (such as Islamic bonds or sukuk which are asset-backed instruments); guarantee schemes (designed to reduce/share risk); diaspora financing schemes (where diaspora communities are supported and incentivized to invest in projects and businesses 'back home'); impact investment (investments that aim to create positive social or environmental returns in addition to a financial return for investors); crowdfunding (the practice of funding a project or venture by raising monetary contributions from a large number of people); social impact bonds (a form of payment for results scheme); countercycli-



cal loan contracts (where debt service automatically falls when a major shock occurs); weather and disaster insurance schemes, and more.

While these developments are undoubtedly positive, important challenges remain. An unexpected consequence of this increased diversity is also a dramatic increase in *complexity*; it can be extraordinarily difficult for a country to understand how it can maximize new financing opportunities, understand new and innovative financing approaches, comply with many different application requirements and understand how to blend and sequence various financing flows to achieve transformational change.

Additionally, while some developing countries are now able to mobilize more domestic resources for development, attract private investment and experiment with innovative finance mechanisms, this is not the case for all. Progress in these areas can be attributed to mostly (large) middle-income economies, while many Least Developed Countries (LDCs), some small island states (SIDS) and fragile states have fewer financing 'options' and remain heavily reliant on traditional donor aid. In addition, some resource-dependent lower-middle income countries that had made significant headway in diversifying sources of external finance during the commodity price upswing in the 2000s have seen their fortunes reverse recently as commodity prices have slumped since mid-2014. For these countries, concessional finance is becoming important again as many face widening fiscal deficits and risks to debt sustainability. Most donors meanwhile are far from achieving the longstanding United Nations target of allocating at least 0.7 percent of GNI to Official Development Assistance (ODA) (donors achieved just 0.3 percent on average in 2016), and the share of total aid allocated to LDCs and SIDS has in fact declined in real terms over recent years. Financing gaps in many countries remain high.

This introductory section of the guidebook summarizes and explains recent and ongoing dynamics in the development financing landscape and considers their implications for the financing of the SDGs, including for particular country categories.

1. The 2030 Agenda: Assessing Financing Needs

The trillion-dollar question: How much will it cost to achieve the SDGs?

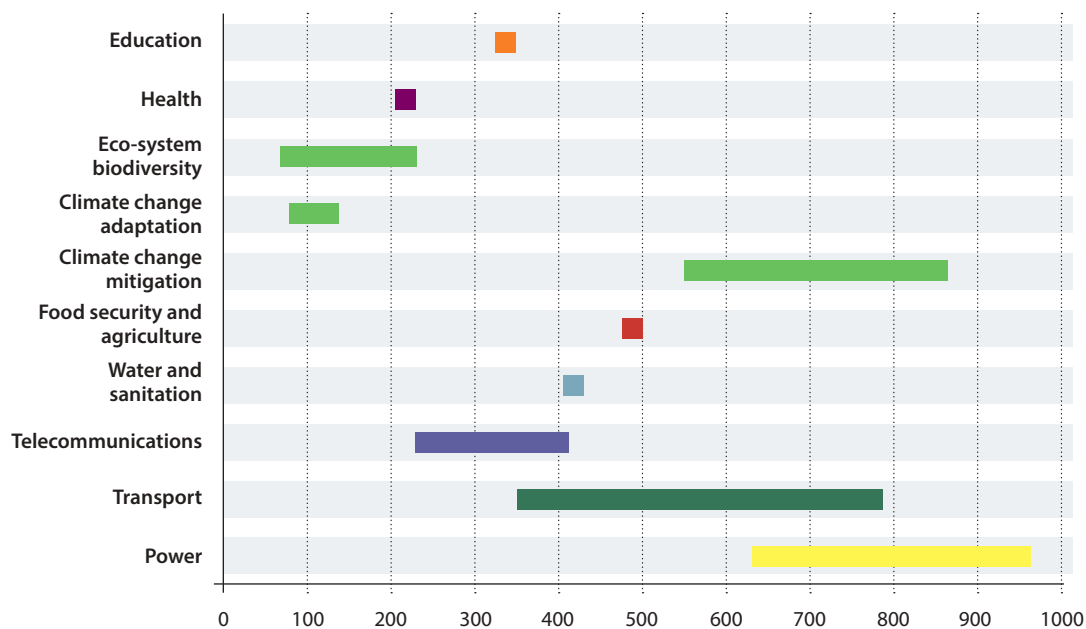


Quantifying financing needs for the SDGs is complex and necessarily imprecise since estimates always rely on a host of assumptions, including the macroeconomic and policy environment, the shape of national and international trade policies, advances in technology (as well as *access* to and capacity to *use* that technology), the predicted impacts of shocks, stresses and climate change, and also the extent to which investments in one area have spillovers (co-benefits or damages) in others. All estimates are however high.



With respect to *social* needs, estimates as to the annual cost of eradicating extreme poverty in *all* countries (measured as increasing the incomes of all people to at least US\$ 1.90 per day) are about US\$ 66 billion annually. Estimates of annual investment requirements in infrastructure in *all* countries (water, agriculture, telecommunications, energy, transport, buildings, industrial and forestry sectors) amount to between US\$ 5 and 7 trillion. Almost US\$ 4 trillion of this corresponds to developing countries, of which only US\$ 1.4 trillion is currently being met (leaving an annual financing gap of US\$ 2.5 trillion according to UNCTAD).³ Global Public Goods (GPGs) provision (e.g. climate change mitigation, biodiversity conservation, communicable disease control, investments in research and science etc.) is estimated at several trillion more per year.⁴

Estimated Annual Investment Requirements, Core SDG Sectors (US\$ billions)



Source: UNDP calculations based on UNCTAD, World Investment Report 2014

³ UNCTAD, World Investment Report (2014):

<http://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=194>

⁴ All estimates from: United Nations Intergovernmental Committee of Experts on Sustainable Development Financing (2014):

<https://sustainabledevelopment.un.org/intergovernmental/financecommittee>



In assessing financing needs however, it is also critical to factor in other considerations, and in particular the potential costs of *inaction* (or of delaying action). For example, delaying climate change mitigation may significantly increase the cost of development over the longer-term (even though in the short-term some apparent ‘savings’ may be made because certain investments are not made).

Financing needs also differ substantially across countries and regions. As explained in the next section, while many large middle-income countries are now able to mobilize more domestic and private resources for development, challenges remain for many low-income countries, some small island developing states, land-locked developing countries and those emerging from conflict. Not only do they need substantial resources to meet the SDGs, they typically have limited capacities to raise domestic revenues (e.g. because small populations are widely dispersed over large distances and/or due to large subsistence and informal sectors), and are also considered less ‘attractive’ options for private investment (e.g. because risks of project failure are high, political instability, poor local infrastructure or other factors).

But even in middle-income countries where various sources of financing may be relatively more “abundant”, the costs of this finance can still be prohibitively high due to perceived or actual higher risk. Moreover, as the recent 2008 financial crisis demonstrated, emerging economies can be vulnerable to so-called “hot-money” flows (speculative investors that move their money between countries to profit from higher interest rates and/or expected changes in exchange rates). These flows can be highly volatile, are typically short-term in orientation, can contribute to domestic inflation and instability. In this respect, *volumes* of finance flowing into (and out of) of an economy tell us very little about the *quality*/development *impact* of those flows. A *qualitative* analysis of the composition and how well resources are used at the country level is required.

In summary, financing estimates are often unreliable and financing needs differ enormously across countries. But while financing estimates may be of interest from an academic point of view, governments are typically more interested in exercises that seek to identify priority or ‘catalytic’ SDG interventions, “cost” those interventions at the national and sectoral levels, and identify the most appropriate financing models for them – an issue this handbook takes up in section two.

2A. Emerging Patterns of Resources: New Opportunities

Over the last fifteen years, developing countries as a whole have increased considerably their abilities to mobilize finance from a range of public and private, domestic and international sources.

Globally, *domestic public* resources are by far the largest and most important source of finance for development. These resources are also country owned and may be spent as countries see fit. The World Bank estimates that emerging and developing econ-



omies mobilized over US\$ 7.7 trillion in domestic revenues in 2012, and that domestic resources have increased by, on average, 14 percent a year annually since 2000. In practice, this means there is over US\$ 6 trillion more each year flowing into developing country treasuries compared with the year 2000.⁵ Buoyant domestic revenues have in turn lowered aid dependency and raised country creditworthiness for official and private non-concessional loans; in 2010, Sub-Saharan African countries collected nearly US\$ 10 in own-source revenue for every dollar of foreign assistance received.⁶ The IMF moreover predicts further large increases in domestic resources over the next few years, especially in middle-income countries. Recent increases have arisen chiefly through the imposition of consumption (VAT-type) taxes combined with income taxes, natural resource revenues and tourism taxes. Transparency and efficiency in tax collection has also improved. Looking forward, many countries have progressively larger labourforces who are middle-income earners and able to contribute to the national tax effort (the so-called demographic dividend).

In parallel, developing countries as a whole have increasingly turned to *private* sources of finance to fund sustainable development. FDI in particular is viewed as a tool to fund economic development and modernization, employment and technology transfer. It is the largest source of international private finance for developing countries. Many developing countries have liberalized policies related to FDI over the last fifteen years and pursued other measures (e.g. tax incentives) to attract investment. In 2016, developing countries attracted FDI inflows of over US\$ 646 billion; this compares to just US\$ 140 billion in Official Development Assistance (ODA) in the same year. Asia in particular has seen major increases in FDI inflows and now receives more than any other world region at 30 percent of total FDI flows.⁷ South-South FDI flows have also expanded.

Bond issuance and commercial bank lending also increased four-fold between 2000 and 2012. Over the last five years, several low-income countries have been able to issue bonds on international capital markets, many for the first time, attracted by relatively low interest rates and enabled by renewed creditworthiness. This includes Rwanda, Zambia and many others.

Many developing countries have also expanded *domestic* debt markets and in some cases developed sub-sovereign debt markets (e.g. municipalities). These developments have enabled countries to secure resources quickly, condition-free and *at-scale* to finance their development. Domestic debt markets have also helped to develop local financial markets and mobilize domestic savings to fund state expenditure. Domestic debt also reduces exchange rate risk and can help to reduce a reliance on aid. Both domestic and international bond financing are expected to further expand as key sources of development finance over the coming years.

⁵ World Bank, Financing for development post 2015 (2013): <http://documents.worldbank.org/curated/en/206701468158366611/Financing-for-development-post-2015>

⁶ Ibid.

⁷ UNCTAD, World Investment Report (2015).



Global financial assets are also considered a potential source of financing for sustainable development. Stocks, public debt securities, corporate bonds, bank deposits etc. amounted to US\$ 294 trillion in 2014.⁸ Redirecting even a small percentage of this total annual investment towards sustainable development objectives could have a major impact. In particular, *institutional* investors (i.e. pension and mutual funds, sovereign wealth funds etc.) which combined hold over US\$ 85 trillion in assets have been identified as a potential source of financing for sustainable development due to their relatively longer-term investment horizons.⁹

Many valuable “sustainable finance” initiatives have also emerged and expanded over recent years (“sustainable finance” is defined as those private investments that are subject to social, environmental, development or other considerations). Impact investment in particular has increased in prominence over recent years. Impact investments are investments in companies, organizations or funds which aim to achieve a measurable social or environmental impact, alongside a financial return.¹⁰ The Global Impact Investing Network (GIIN) estimates a market of approximately US\$ 114 billion in impact investing assets, of which US\$ 22.1 billion was committed in 2016. Expected growth in 2017 is over 25 percent. Sixty percent of impact investors (respondents to GIIN surveys) report their investments are aligned to the SDGs.¹¹ Many large companies have also created or expanded corporate social responsibility programmes with a key focus on international development. There is also increasing interest in and use of environmental and social governance (ESG) indicators by international investors. In some countries (e.g. the South African and Thai stock exchanges), ESG reporting is being promoted. This has some potential to direct larger volumes of private finance to sustainable development in the medium to long run.

Philanthropic foundations have also expanded their international development cooperation activities over recent years, and have become key partners to traditional bilateral and multilateral development agencies. While the large international philanthropists tend to dominate the headlines (the Gates Foundation, Ford Foundation, Open Society Foundation etc.), it is also important not to overlook (nor understate) the role that small *domestic* foundations often play in national and local development efforts (in both industrialized *and* developing countries). Private aid is estimated at between US\$ 60-70 billion annually (about half that provided by OECD DAC donors).

Diaspora resources represent another key source of financing for development. Private cross-border transfers from individuals have increased substantially over recent years.

⁸ IMF, World Economic Outlook (2015): <http://www.imf.org/external/pubs/ft/weo/2015/01/>

⁹ Boston Consulting Group (2015).

¹⁰ See: Global Impact Investing Network: <https://thegiin.org/impact-investing/>

¹¹ See: Global Impact Investing Network, Annual Impact Investor Survey (2016): https://thegiin.org/assets/2016%20GIIN%20Annual%20Impact%20Investor%20Survey_Web.pdf Impact investments are made mostly by fund managers and philanthropic foundations in a wide variety of economic sectors such as housing, microfinance, energy and food and agriculture. Private equity and debt are by far the most commonly used instruments by impact investors with only a few testing so-called ‘pay-for-performance’ schemes.

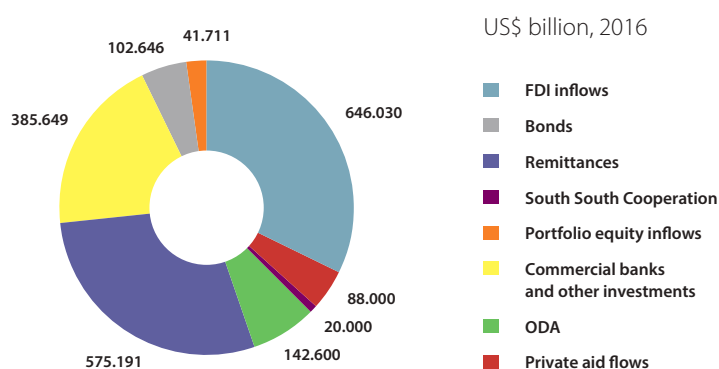


An estimated US\$ 575 billion was remitted to developing countries from migrants in 2016, and remittance flows are typically more stable than other resource flows. New (for-profit and not-for-profit) platforms have also emerged to facilitate diaspora investments “back home” (e.g. We are Movement) in areas such as infrastructure.¹²

When it comes to *public* flows, international public finance flows have also increased in *volume terms* over the last fifteen years, albeit not as rapidly as private flows. ODA reached about US\$ 140 billion from OECD DAC donors in 2016, up from just US\$ 60 billion in 2000. South-South Cooperation – which encompasses a heterogeneous mix of concessional and non-concessional finance, technical assistance and trade and investment flows – has also risen substantially with further increases expected. China’s ‘Belt and Road’ initiative, for example, which involves China underwriting billions of dollars of infrastructure investment in over 60 countries of Central Asia is undoubtedly the most ambitious economic development venture funded by a foreign power at the current time. The UN estimates South-South Cooperation flows at around US\$ 20 billion annually, but this is probably underestimated since data is unreliable.¹³ This finance is being channeled through a variety of intermediaries: from traditional aid-type agencies to bilateral export and development banks (such as Brazil’s Development Bank – BNDES) to multilateral financial institutions (such as the new Asian Infrastructure Investment Bank and the New Development Bank).

In summary, there is a departure from a model in which development aid and international public finance play a major role in the financing of sustainable development towards a model in which transformation and development are being driven by multiple poles of mainly private capital accumulation.

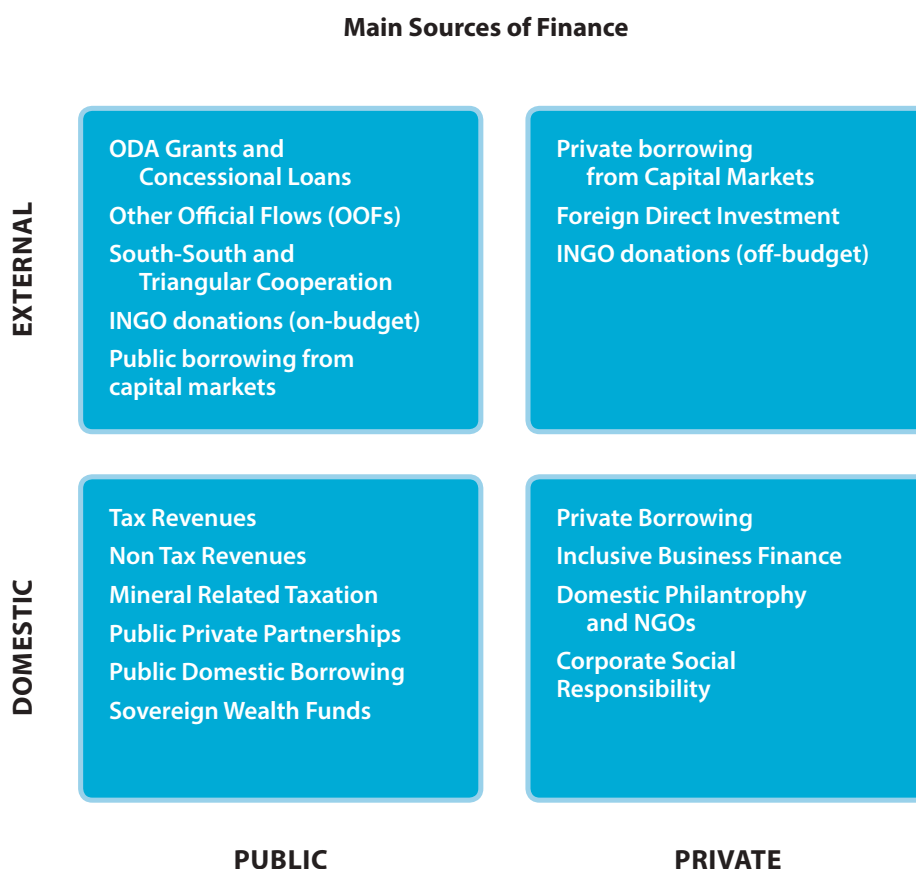
International Capital Flows: Developing Countries (2016)



Source: UNDP calculations based on data from the World Bank, IMF, UNCTAD and other sources

¹² See We are Movement: <https://www.wearemovement.com/>

¹³ In practice, estimates as to the volume of South-South Cooperation are unreliable since many providers do not report consistent or comparable data on a regular basis.



Source: UNDP 2016

2B. Emerging Patterns of Resources: Challenges and Limitations

Despite these opportunities, important challenges remain.

For example, increasing domestic revenue mobilization remains a challenge for many governments, particularly in low-income countries (LICs). LICs frequently have narrower fiscal bases reflecting a dependence on one or two commodities and a smaller share of the formal sector in employment or formal business activity. Domestic revenues are also affected by the volatility of the sectors being taxed (e.g. commodity prices can fluctuate widely). Greater trade liberalization meanwhile has *reduced* the share of trade-related taxes in many countries, and there is sometimes a reluctance to tax other incomes or assets (e.g. land or property) for political or other reasons. 'Green' taxes in many countries remain relatively small. In some countries therefore, while the tax take has expanded, it may not have been especially progressive (e.g. a reliance on consumption taxes).



Low tax-to-GDP ratios are exacerbated by high levels of capital flight and limited capacity (or willingness) to collect revenues from multinationals, particularly those engaged in natural resource extraction. Over the last decade, the term “illicit financial flows” has emerged and represents a “catch-all” term used to describe both *legal* (e.g. tax avoidance) and *illegal* (e.g. tax evasion, theft and other criminal activity) movements of capital across borders. It is increasingly recognized as a major development problem. UNDP estimates that each year, illicit financial flows (trade mis-invoicing only) from the LDCs are roughly equivalent in volume terms to the amount of development aid received by those same countries (at about US\$ 28 billion).¹⁴ Globally, illicit outflows (trade mis-invoicing only) are estimated at almost US\$ 1.1 trillion.¹⁵ Moreover these amounts do not capture other illicit outflows of capital associated with the illegal trade in wildlife, fish, arms, narcotics and people etc.

Tax Avoidance Schemes: the Panama and Paradise Papers

A series of high-profile data leaks released by the International Consortium of Investigative Journalists (ICIJ) in recent years have uncovered the offshore financial dealings of prominent wealthy individuals, multinational corporations and political leaders worldwide, often used as strategies to avoid paying tax in their home jurisdictions.

In November 2017, the ‘Paradise Papers’ investigation released findings from a cache of 13.4 million records obtained from the offshore law firm Appleby and corporate service providers Asiatic Trust and Estera, involving 19 tax havens.¹⁶ The files expose the secret transactions of more than 120 politicians and 100 multinationals, including from developing countries. The investigation also revealed unethical financial transactions involving commodities and mining conglomerates operating in some of the world’s poorest countries.

Similar revelations emerged in 2016 from the ‘Panama Papers’, a similar investigation of 11.5 million documents leaked from Panamanian law firm Mossack Fonseca.¹⁷ The investigation detailed how law firms and major banks conspire to conceal the sometimes illegal offshore financial dealings of politicians, criminals, wealthy individuals and celebrities.

¹⁴ UNDP, *Illicit Financial Flows from the Least Developed Countries: 1990-2008* (2011): http://content-ext.undp.org/aplaws_publications/3273649/IFFs_from_LDCs_web.pdf

¹⁵ Global Financial Integrity, *Illicit Financial Flows from Developing Countries: 2004-2014* (2015): <http://www.gfintegrity.org/report/illicit-financial-flows-from-developing-countries-2004-2013/>

¹⁶ For further information, see: the International Consortium of Investigative Journalists (ICIJ): <https://www.icij.org/investigations/paradise-papers/about/>

¹⁷ For further information, see: the International Consortium of Investigative Journalists (ICIJ): <https://panamapapers.icij.org/20160403-panama-papers-global-overview.html>



“Plugging” these leaks could clearly have a major positive impact on development. But while there are actions that countries can take at the national level to curb “illicit” outflows of capital (e.g. improve macroeconomic and political stability; strengthen tax administrations etc.), there is also a need for coordinated action at the international level to crack down on tax havens, share tax information more readily between countries and return stolen assets. Progress in many of these areas remains slow and difficult. For UNDP, an added challenge is that several of our programme countries are also important international financial centres and while they are often not the most “systemically” important ones, they nevertheless rely on financial services to support their economies and it is not immediately obvious what alternative development strategies may be on offer for them.

Inefficient *expenditures* further compound the problem of low tax revenues. Governments often face political or other pressures to use resources in sub-optimal ways, which can be resistant to public expenditure management reform efforts. This is especially the case where informal institutions such as systems of patronage, circumvent attempts to improve budgetary processes and transparency. For instance, in ‘winner-takes-all’ political systems, fiscal consolidation through expenditure cuts could be directed towards maintaining client and kinship networks to the exclusion of others. This can explain why some subsidies (e.g. fossil fuel, agricultural and fisheries subsidies) or tax advantages (e.g. on land ownership) are so difficult to eliminate despite their obvious adverse impact on government finances and the environment. Institutional corruption, i.e. where corruption is either seen as necessary to expedite transactions or even acceptable because it is widely practiced, is an additional constraint on efficient public expenditure management. However, adoption of anti-corruption reforms can also be captured by political interests and targeted at government opponents, leading to further diversion of scarce resources and capacity. Given these skewed incentives, expenditures may not necessarily translate into development *results*.

Even where corruption is not viewed as a major problem, there are other challenges. Budgeting processes may not be well aligned to national development priorities or sensitive to vulnerable groups such as women, indigenous peoples or the disabled etc. In many rural or isolated areas, education or health outcomes can be low despite *higher* levels of per capita spending. There may be little accountability for implementation, which is often reflected in repeated underexecution of capital expenditures. Some governments respond to pressures to increase development spending with overly optimistic budgets, based on unrealistic revenue projections, rather than implement urgent expenditure reforms. The inevitable revenue shortfalls can result in accumulation of payment arrears, cuts to development spending and an overreliance on deficit financing, further damaging the credibility of the budget process and sowing the seeds of possible economic crisis further down the line. Others resort to costly domestic and/or international borrowing to fund public infrastructure with little regard for the *quality* of the investments. Under these circumstances, helping developing countries reprioritize and render more effective *existing* expenditures will also be an important component of financing Agenda 2030.



When it comes to *private* financial flows there are also constraints and difficulties. FDI's sustainable development benefits are not uniform for example. Investments are increasingly being made in real estate versus manufacturing or research and development, and FDI may not be environmentally responsible. FDI in the extractive industries sector for example may have harmful environmental impacts and have limited linkages with the rest of the economy, despite its contribution to economic growth. It can be volatile and fluctuate significantly from one year to the next. Additionally, FDI is heavily concentrated in middle-income countries and in resource-rich low-income countries with the Least Developed Countries attracting less than 2 percent of total world FDI flows.¹⁸ The *quality* of FDI is therefore critical for its impact on sustainable development.

Greater use of bond and commercial bank debt also carries some risks. Private debt is typically procyclical, carries shorter maturity profiles and is often more expensive than official sector debt. Governments can often find it difficult to extend maturities beyond a few years, leaving them vulnerable to refinancing risk (especially in economic downturns). While in many cases, *external* debt ratios have declined, this hides the reality that governments have simply replaced (cheaper) external debt with (more expensive) domestic debt (see debt box for further elaboration). With the human and economic costs of debt crises extremely high, debt sustainability considerations must remain at the fore.

Additionally, despite a keen interest in how institutional investors may contribute to sustainable development, the reality is that very few currently invest large (or any) shares of their portfolio in developing nations (citing fiduciary obligations to their clients). Sustainable finance initiatives meanwhile remain far from mainstream. Directing more *private* financial flows to sustainable development therefore remains a considerable challenge.¹⁹

With respect to international public finance flows, while ODA has increased in volume terms over recent years, very few donors meet the longstanding commitment to allocate at least 0.7% of their GNI to ODA (just 5 countries in 2016), and prospects for large increases in aid are not bright due to fiscal pressures in some high-income donor

¹⁸ World Bank, Financing for Development Post-2015 (2013): <https://www.worldbank.org/content/dam/Worldbank/document/Poverty%20documents/WB-PREM%20financing-for-development-pub-10-11-13web.pdf>

¹⁹ Limited investment by institutional investors in developing countries is due to a variety of factors, but in particular perceived higher risk and also a lack of “bankable” projects in which to invest. Even in industrialized economies, investments by international institutional investors in major ‘gap’ sectors such as infrastructure have been insufficient with many exhibiting a preference for perceived low-risk and short-term assets. Indeed, a recent trend for some institutional investors (and by pension funds in particular) is an increase in investment in so-called “alternative asset classes” such as private equity, venture capital and real estate. However, because they often lack the expertise to invest directly in these areas, they instead channel these investments through intermediaries such as private equity and hedge funds. Expanding the chain of intermediaries however increases “principal-agent” problems, with incentives increasingly less aligned with the aims of the initial investor as well as with public policy goals. These challenges will need to be overcome if the investments made by institutional investors are to be more effectively leveraged in support of sustainable development.



countries and a weak political commitment to ODA.²⁰ Moreover, aid remains heavily concentrated in just a few countries. The MDG Gap Task Force reported in 2015 that the 10 countries received 37 percent of total aid flows in 2013; the top 20 received 57 percent.²¹ Paradoxically, LDCs and SIDS, which are the countries most reliant on development aid, have seen the lowest increases in aid over recent years relative to other developing countries.²²

This is combined with pressure to allocate larger shares of ODA to climate/environment related interventions, humanitarian interventions and on hosting refugees in donor countries in line with rising need in these areas. In 2015, ODA for humanitarian interventions reached an all-time high at US\$ 25 billion.²³ Climate-related ODA reached US\$ 37 billion in 2013, of which 61 percent addressed mitigation.²⁴ In 2016, 10 percent of total ODA was spent on meeting refugees' needs in donor countries.²⁵ Should these trends continue, they will have an important impact on *where* ODA flows in the future (i.e. the countries that will benefit).²⁶ Some OECD DAC donors are also providing larger shares of their ODA as loans, especially for middle-income countries prompted by renewed or improved creditworthiness in many countries. While increases in finance from South South providers is welcome, transparency in their activities is emerging as an increasingly important issue.

The *quality* of ODA also matters. The MDG period saw an increased focus on the *effectiveness* and *impact* of development aid which culminated in a set of principles on aid effectiveness being endorsed by OECD DAC donors in 2005 in Paris and in 2008 in Accra. The principles outlined a series of measures donors should take to improve the quality of their aid, including alignment with national priorities and improved coor-

20 See: United Nations MDG Gap Task Force Report, Taking Stock of the Global Partnership for Development (2015): http://www.un.org/en/development/desa/policy/mdg_gap/

21 See United Nations MDG Gap Task Force Report, Taking Stock of the Global Partnership for Development (2015): <https://www.un.org/development/desa/dpad/publication/taking-stock-of-the-global-partnership-for-development/>

22 See: OECD, Taking stock of aid to the least developed countries (LDCs) (2016): https://www.oecd.org/dac/financing-sustainable-development/Taking_stock_of_aid_to_LDCs_Flyer_2015.pdf and UNDP, Financing for Development in Small Island Developing States (SIDS): A snapshot and ways forward (2015): <http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/FfD-SIDS-UNDP-OHRLLS.html> and OECD, Small island developing states and the post-2015 development finance agenda (2015): <https://www.oecd.org/dac/financing-sustainable-development/Addis%20Flyer%20SIDS%20FINAL.pdf>

23 UN Office for the Coordination of Humanitarian Affairs (OCHA), Financial Tracking Service: <https://fts.unocha.org/>

24 OECD, Climate and environment related development finance (2015): <http://www.oecd.org/dac/financingforsustainabledevelopment/FINAL%20-%20Flyer%20-%20Climate%20related%20dev%20finance%20.pdf>

25 OECD, Development aid rises again in 2015, spending on refugees doubles (2016): <http://www.oecd.org/dac/development-aid-rises-again-in-2015-spending-on-refugees-doubles.htm>

26 With Global Public Goods provision, a key consideration for aid providers is where resources will have the biggest impact at the lowest cost. Objective need, poverty levels or income per capita are not necessarily the most important considerations. This may skew resources away from some smaller and/or poorer countries towards large emerging economies.



dination amongst themselves.²⁷ Other donors and development partners joined this effort in 2011 on a voluntary basis under the banner of the Global Partnership for Effective Development Cooperation (GPEDC) which aims to guide efforts to improve the effectiveness and impact of all forms of cooperation for development.²⁸

Despite this progress, challenges around aid and development effectiveness remain. Both UNDP and the OECD report that progress remains mixed around many donor aid effectiveness commitments, such as a promise to use country systems, coordinate better or fully untie aid. Predictability and transparency are also among the so called ‘unfinished’ aid effectiveness agenda. Approaches to improving aid and development effectiveness also vary among South-South Cooperation providers and private aid providers (such as philanthropic foundations). Continued efforts to strengthen aid and development effectiveness will also clearly make an important contribution to sustainable development efforts.

In summary, for many countries, large investments in key SDG-related areas such as sustainable infrastructure cannot be realized without some form of external finance. The *quality* of this finance – whether from the public or private sector – is key. For some countries, such as LDCs and some SIDS, an exit from aid dependence cannot be expected any time soon. Outflows of capital from developing economies remains a key challenge. That said, many developing countries – and in particular large middle-income economies – are now able to leverage a much broader range of domestic and international private financial flows to fund their development than they were 15 years ago.



UNDP

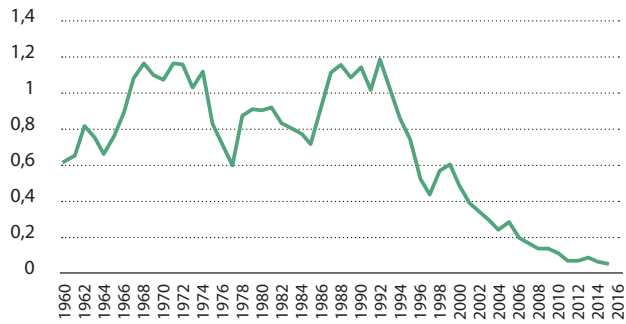
²⁷ See: OECD, Paris Declaration and Accra Agenda for Action (2005 and 2008): <http://www.oecd.org/dac/effectiveness/parisdeclarationandaccraagendaforaction.htm>

²⁸ See: Global Partnership for Effective Development Cooperation: <http://effectivecooperation.org/>

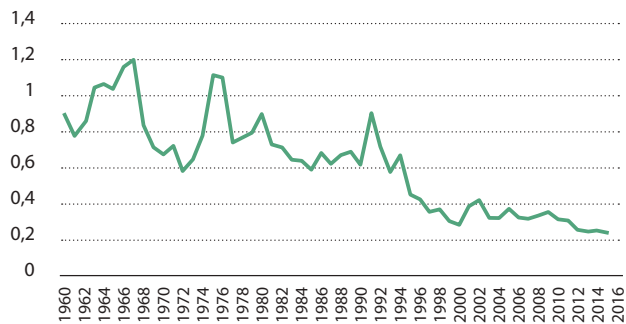


ODA has Diminished Significantly as a % of GNI Across all Developing Regions

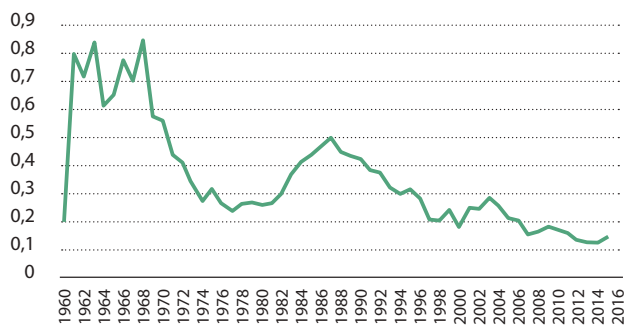
Particularly
in East Asia &
Pacific



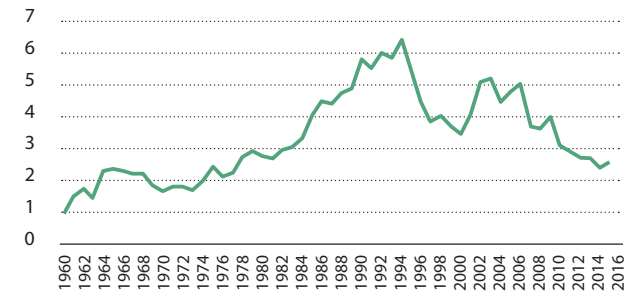
and South Asia



Latin America
& the Caribbean



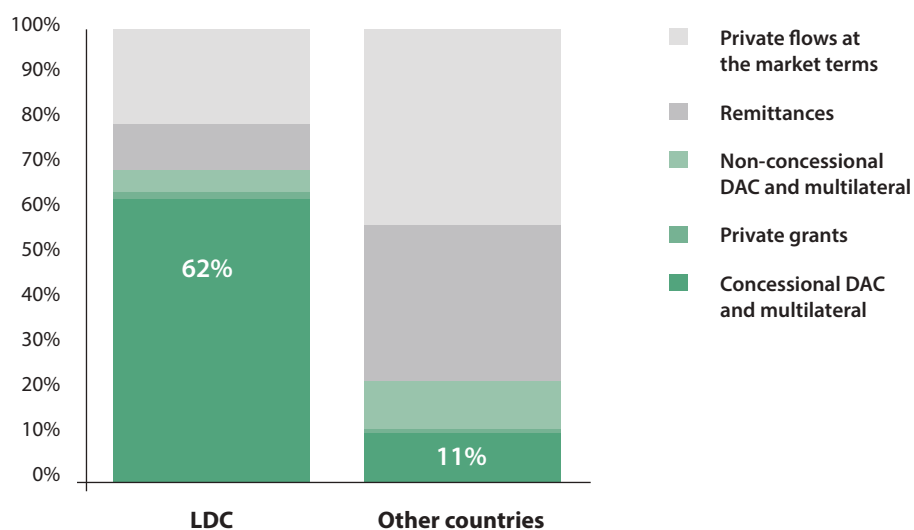
But remains
relatively
significant in
Sub-Saharan
Africa, which
has the largest
proportion
of LDCs



Source: OECD DAC



Composition of External Finance in the LDC versus other Developing Countries



Source: OECD (2016)

3. An Age of Choice? Diversity and Innovation in Financing Approaches

In much the same way as *sources* of finance have expanded over recent years, so has the variety and sophistication of financial instruments and financing approaches. The ways in which resources are both *mobilized* and *spent* have become increasingly ‘innovative’ and diversified. This has been supported in turn by innovations in technology that have led to the financialization of ‘real’ markets, increased interdependence/integration of financial markets, the introduction of new crypto-currencies, and facilitated access to financial markets by previously excluded people (e.g. via mobile and smartphone technology). Collaborations between public and private actors to deliver sustainable development outcomes have also become commonplace.

Innovations in financing involve innovations in the way resources are both *mobilized* as well as *delivered*. Some of these are outlined in the table below. Part 4 of this guidebook explores in detail how many of these instruments have been used in practice throughout the world. UNDP uses the term “financing tool-box” to describe this increased diversity.



Instrument	Description	Funding/Asset Type
INNOVATIONS IN RESOURCE MOBILIZATION		
Airline ticket tax	Additional tax levied alongside existing airline taxes in participating countries, which is channelled to UNITAID for health spending	Domestic tax revenue
International Finance Facility for Immunization (IFFm)	Bonds issued on international capital markets to pay for child immunization repayable by future aid	Fixed income debt
Crowdfunding	Funds raised for a project by soliciting monetary contributions from large numbers of people chiefly through the internet	Donations, peer-to-peer loans and equity investments
Diaspora financing	Funds raised from the diaspora for development projects	Fixed income (bonds), unilateral transfers (remittances) and foreign direct investments (e.g. equity)
Green bonds	Bonds which invest proceeds in environmental projects	Fixed income debt
Sharia compliant (Islamic) finance	Risk/reward sharing contracts such as sukuk (Islamic bonds) that provide investors with an equity stake in the underlying asset	Asset-backed debt- and equity- like instruments, insurance and welfare transfers
Social and development impact bonds	Upfront capital provided by investors for specific interventions, which are repaid by donors/governments only if desired results are achieved	Pay-for-success, public private partnerships scheme
Debt swaps/buy-backs	A portion of debt is cancelled and the foregone debt service channelled to environmental protection or social projects	Bilateral and Commercial debt forgiveness
INNOVATIONS IN RESOURCE DELIVERY		
Vertical funds	Public-private partnerships that funnel money to one or two key causes	Grants and loans from a large number of public and private sources
Blended finance	Public aid monies or private philanthropic funds are mixed with public or private sector loan financing	ODA, foundation grants and commercial debt
Lending in local currencies	Mechanism to reduce currency risk	Debt (bonds and loans)
GDP-indexed loans	Lending that link debt repayments to fluctuations in economic output	Official and private debt
Countercyclical loans	Loans where debt service is allowed to fall when a major shock occurs	Concessional bilateral sovereign debt
Weather or catastrophe insurance schemes	Products that provide pay-outs to sovereigns or farmers when a major weather disaster strikes	Disaster risk insurance
Guarantees for development	A type of insurance policy that protects governments, banks or investors from the risk of non-payment or loss of value of an investment	Country risk insurance



In particular there has been a major proliferation in multilateral and bilateral funds (and mixed public-private funds) for climate and biodiversity finance over recent years. Many fund managers use, in turn, innovative approaches to both mobilize resources as well as carry out their mandate, including payment for environmental services, carbon and biodiversity offsets, benefit-sharing/revenue-sharing schemes, payments for results and certification mechanisms.

The Financing Tool-Box

Bonds	<ul style="list-style-type: none"> • Sovereign bonds issued on international and domestic markets • Diaspora bonds • GDP-linked bonds • Green/blue bonds • Social impact bonds • Development impact bonds
Loans and guarantees	<ul style="list-style-type: none"> • Loans (<i>Including:</i> Multilateral and bilateral development banks, other official flows (OOFs), counter-cyclical loans, contingent credit facilities, development policy loan deferred draw-down options, catastrophe risk deferred, drawdown options, debt buy backs, debt-swaps, blended finance, public-private partnerships, guarantees)
Public Revenue	<ul style="list-style-type: none"> • Taxes and levies (<i>Including:</i> income taxes, value added/consumption tax, property taxes, tariffs, green taxes, domestic financial transaction tax, airline ticket tax)
Insurance	<ul style="list-style-type: none"> • Weather index-based insurance • Catastrophe Risk Insurance Facility
Funds	<ul style="list-style-type: none"> • Vertical Funds (e.g. GAVI Alliance, Global Fund and UNITAID, Adaptation Fund, Global Environment Facility, Green Climate Fund, Securities and structured funds) • Microfinance investment funds
Grants	<ul style="list-style-type: none"> • Official Development Assistance (ODA) • Philanthropic and other private donations

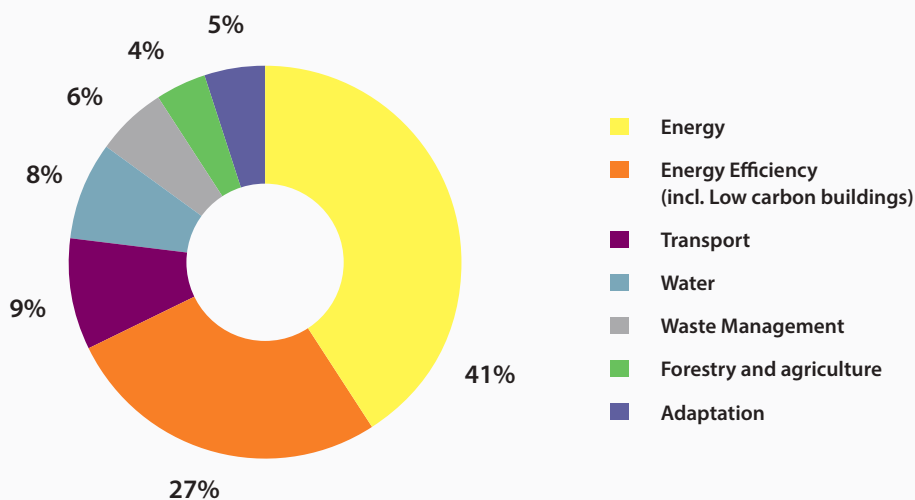
Source: UNDP (2015)



Green Bonds: an Innovative Financing Instrument that has Gathered Pace

Green bonds are one of the largest and most well-known of the recent innovations in finance. “Green bonds” are instruments that tie the proceeds of a bond issue explicitly to environmentally-friendly investments. These include clean transportation, energy efficiency, sustainable energy investments, waste management and climate change adaptation.²⁹ The Climate Bonds Initiative estimates that bonds explicitly labelled as “green” which earmark 100 percent of their proceeds to a specific environmental purpose exceeded US\$ 118 billion in 2016.³⁰ Issuers of bonds can be supranational institutions (such as multilateral development banks), public entities (municipal, state or federal) or private companies. Several large emerging economies such as Brazil, China, India, Mexico and South Africa have built dynamic green bond markets at the domestic level over recent years. More recently, the Seychelles has become the first country to issue a “blue” bond. Modelled on green bonds, proceeds from the first ever blue bond issuance will be channelled to investments in marine protected areas, sustainable fisheries development and management in the Seychelles.³¹

Green Bonds: use of Proceeds (2016)



Source: Climate Bonds

²⁹ See: Climate Bonds, Scaling-up green bond markets for sustainable development (2016): https://www.climatebonds.net/files/files/GB-Public_Sector_Guide-Final-1A.pdf

³⁰ See: The Climate Bonds Initiative: www.climatebonds.net

³¹ For further information, see: First World Bank 'Blue Bond' Approved for Seychelles, 5 October 2017: <http://sdg.iisd.org/news/first-world-bank-blue-bond-approved-for-seychelles/>



An extensive literature exists which examines both the potential and the limitations associated with different innovative financing approaches.³² Much of this literature has explored the extent to which different financing instruments and delivery channels:

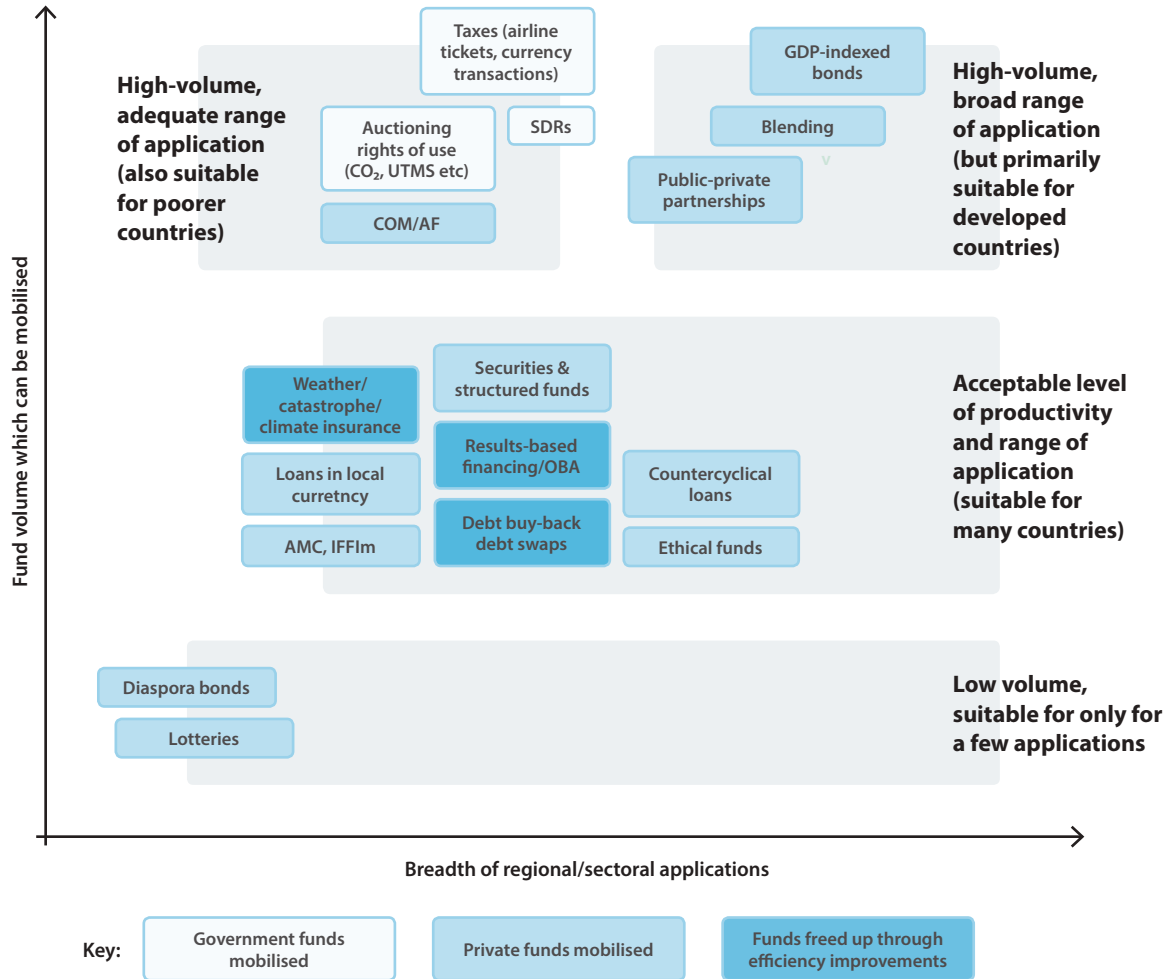
- leverage *additional* resources *at-scale* for sustainable development;
- provide opportunities for new collaborations based on the strengths/expertise of each stakeholder;
- deliver resources efficiently in a stable and predictable manner;
- are easy to access;
- resolve or accentuate fragmentation and coordination challenges;
- reduce vulnerability;
- are suitable for countries at different income levels;
- are suitable for different interventions, and;
- have high transaction costs.

The German Development Bank (KfW) has produced a useful illustration which summarizes the revenue potential of different instruments and their suitability to different countries. Some have the potential to mobilize resources at-scale and have a broad range of applications (e.g. blended finance); others remain largely untested/underexplored (e.g. diaspora bonds).

³² See for example: UNDP, Innovative Financing for Development: A New Model for Development Finance? (2012): http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/development_cooperationandfinance/innovative_financingfordevelopmentanewmodelfordevelopmentfinance.html



Innovative Financing for Development: Options and Potential



Source: Adapted from KfW (2012)

While some of these instruments and approaches have gathered pace and are now widely used (e.g. blended finance and green bonds), others remain small in scale despite their potential (e.g. debt swaps and countercyclical loans). Obstacles to their further use vary depending on the instrument, but include capacity constraints (expertise on the financier's side as well as the beneficiary's side), a lack of information, an aversion to risk, legislative restrictions (e.g. restrictions on how aid money can be used), and political constraints (e.g. lack of interest).



It is also important to note that, while there has been a recent explosion in the number of new *funds* for development, especially in the areas of climate change, biodiversity conservation and health, this apparent abundance masks the under-capitalization of many of them. Rather than reflecting increasing available resources for sustainable development, the development of new financing approaches appears as a sub-optimal response to a persistent and unresolved financing gap.³³ And while many new funds are public-private partnerships, they nevertheless rely heavily on donor aid flows as a major source of funds.

Moreover, while this diversity has many positive aspects, a (perhaps unintended) consequence is a dramatic increase in complexity; countries are tasked with the challenge of identifying which funds are appropriate for them and are currently capitalized, which they are eligible for, how to access resources, how to blend them to support transformative change and how to develop cost effective methods to apply for, monitor and evaluate results. This is a particular problem in relation to climate finance and has meant that many of the countries most vulnerable to climate change (e.g. small islands and least developed countries) have found it difficult to access this financing (due to limited capacities). Many rely on the support provided by development partners such as UNDP and others to help them in this effort.

Similarly, only some countries have been able to make effective use of some of these innovative financing instruments found in the financing “tool-box”. For example, while several large middle-income countries have used blended finance arrangements to fund infrastructure investments and/or issued green bonds, these financing modalities are more challenging for many low-income countries. Development impact bonds have not yet been used to any real scale. Additionally, finance providers are often more averse to “testing” some of these innovative approaches in low-income perceived riskier settings. Capacity building support will be a prerequisite for many countries seeking to maximize the opportunities presented by a more sophisticated financing “tool-box”.

4. Financing for What?

It is obvious (but sometimes overlooked) that different sources of finance have very different “characteristics” that make them more (or less) suitable for the financing of different interventions; not all dollars are the same! Similarly, no two countries are exactly the same – which means the right “financing mix” will differ from one country to the next.

For example, some flows are *procyclical* in nature and are cheaper and more abundant

³³ For further elaboration on this topic, see: UN System Task Team on Financing for Sustainable Development, Chapter 4, Public support to private investment (2014): <https://sustainabledevelopment.un.org/content/documents/2111Chapter%204-public%20support%20to%20private%20investment.pdf>



in good times (e.g. many private financial flows), while others perform an important *countercyclical* function (e.g. finance from the multilateral financial institutions). Flows are disbursed in different currencies and at different speeds (project financing from some multilateral development banks can take considerable time to be approved and disbursed while tapping international capital markets can be fast). Some financing has conditionalities attached to it (e.g. tied aid or policy conditions) while some is condition-free. Loans can have short or longer-term maturities and different interest costs. Some financing may come with helpful technical assistance or technology transfer, and in other cases this (mandatory) technical assistance is unwanted. Financing can be on-budget and channelled through country systems and in other cases, it is channelled through intermediaries (that governments may or may not hold a favourable view of and/or that have high overhead costs). Some donors can be unpredictable or unreliable, making aid a volatile source of finance in some instances. Funding may be offered to support national priorities or it may be “supply” driven. But even in cases where resources are offered to support “non-priority” development areas, it may still be expedient for a country to accept them due to a desire/need to foster deeper political or strategic ties with a particular funder. When it comes to *domestic* resources and proposals to reform domestic taxation systems and/or implement new taxes, powerful political or business interests may resist these even though there may be a strong rationale/benefit for the proposed reforms.

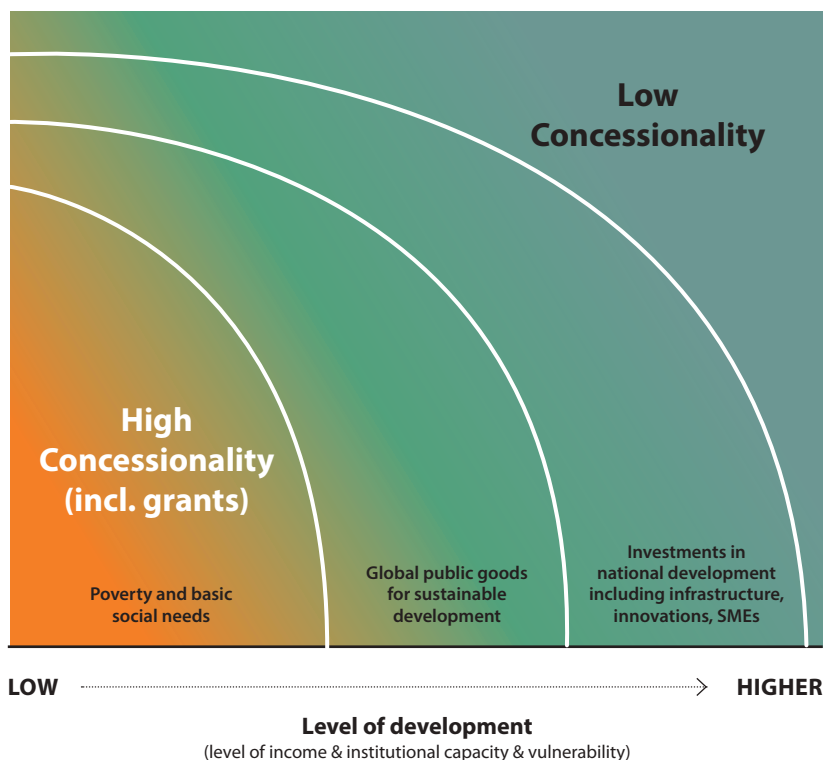
Critically, “what” you are financing matters. As an illustration, many donors take the view that grants and highly-concessional loans are appropriate for financing poverty reduction and basic social needs in the poorest countries; conversely loan financing can be used to fund investments in infrastructure and the development of small and medium-sized enterprises (SMEs), especially in higher-income developing nations.

In its 2014 report, the UN’s Inter-governmental Committee of Experts on Sustainable Development Financing (ICESDF) reflected this emerging consensus with the following illustration. The challenge however is that sometimes governments and investors over-estimate the economic return that infrastructure investments are likely to generate (or the economic return does not happen as quickly as was anticipated).

These considerations illustrate some of the many complexities involved in developing a national financing strategy. It can often be extremely difficult for governments to determine which financing instruments and approaches to use, in which circumstances and what debt policies to adopt to ensure debt remains sustainable, while at the same time balance this with foreign policy or other considerations. These considerations must all be taken into account when supporting countries to develop and implement financing strategies that are most suited to their specific circumstances and needs.



Indicative Targeting of International Public Financing According to Countries' Levels of Development and Different Sustainable Development Needs



Source: UN, 2014

5. Is Money Everything? Financial versus Non-financial Means of Implementation

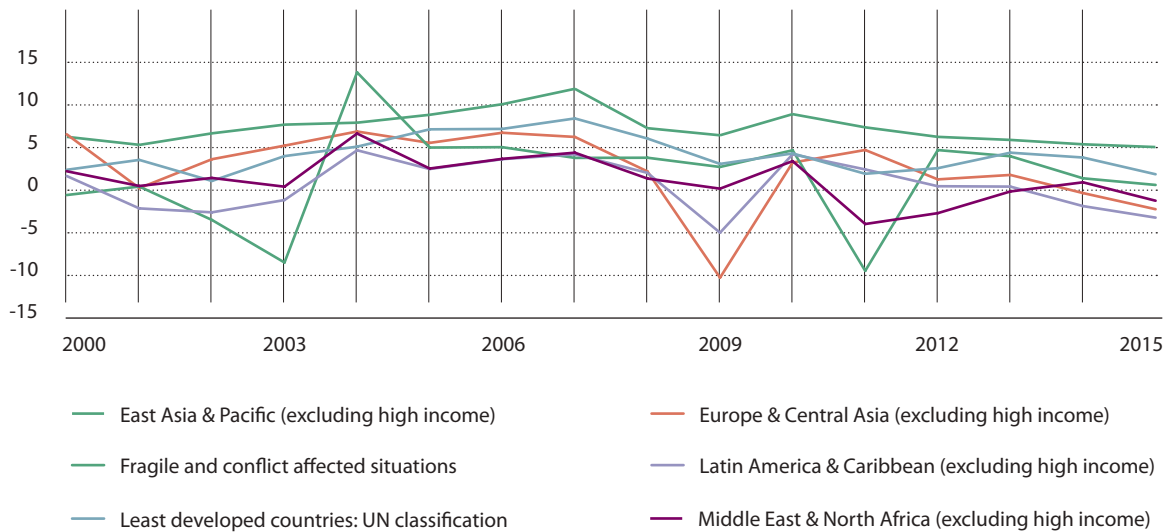
Money clearly matters. But how much does money matter versus other 'non-financial' means of implementation? Multiple other factors clearly influence sustainable development outcomes, such as (most importantly) a political commitment to use available financial resources effectively and transparently or regulatory provisions which may shift households' and company behaviour in the way resources are used and invested. Some are endogenous (e.g. institutional capacity, natural resource endowment), while others are exogenous (e.g. access to knowledge and technology, international trade rules, vulnerability to environmental hazards and climate change, amongst others).



5.1. Global Economic Conditions Matter

One of the most important ‘enablers’ for economic development in developing countries is strong and sustained global economic growth. Global economic conditions matter and – as shown by the data – developing countries are deeply impacted by fluctuations in economic output in high-income and emerging economies. The figure below illustrates how patterns of GDP growth across countries exhibit a very high degree of correlation (notwithstanding the inevitable few outliers). This reveals a high degree of cross-border economic interdependence and a convergence of business cycle synchronization. Thus, economic slowdowns in the high-income world spillover to impact developing countries around the world. Under such circumstances, investors are often more sensitive to risk and capital may well flow to those countries with more robust track records in project implementation and which are perceived as safer bets. In this environment, lower-income countries may lose out.

GDP Growth (annual %): Worldwide



Source: World Bank, 2016



5.2. Other Non-financial Means of Implementation

The Addis Ababa Action Agenda (AAAA) attempts to reflect other “non-financial” dimensions of an enabling international environment when it speaks of the need to enhance, *inter alia*: international coordination for macroeconomic stability; take measures to ensure safe and orderly international migration; combat terrorism and transnational crime (that can have deleterious impacts on development); create and diffuse innovations and new technologies (as well as build the capacities of countries to use them); improve international cooperation on tax; incentivize research; and take action to combat climate change.³⁴ Attention has also focused on the potential of regional integration to accelerate development.

The literature on financing for development also explores the incentives and regulations that governments can put in place at the national level to steer private investment in different directions and to ensure that more private investment is allocated to investments that yield sustainable development returns as well as financial returns. This means going far beyond philanthropy and voluntary corporate social responsibility (important though they are): it implies active interventions to steer the investment decisions that private actors make every day. These are made in the real economy, by companies small and large, as well by a broad range of actors in the financial sector such as banks, pensions companies and hedge funds to name a few.

It involves a variety of public policy measures, such as: incentive schemes to help realign business decisions to the SDGs (e.g. taxes or other restrictions on carbon emissions or other harmful activities); the adoption of mandatory environmental and social impact reporting; and changes in government procurement policies (as governments are major purchasers of goods and services from the private sector). This must be accompanied by measures to promote and sustain an endogenous shift in households’ behaviours and market preferences to allow for a gradual internalization of the SDGs in market dynamics, (e.g. consumers voluntarily opt to purchase products that respect certain environmental or social standards). This approach views consumers, businesses and investors not only as providers of capital, but as agents of positive change. UNDP’s “Growing Inclusive Markets” is one initiative that seeks to understand, enable and inspire the development of more inclusive business models around the world that will help to create new opportunities and better lives for many of the world’s poor.³⁵

³⁴ United Nations, Addis Ababa Action Agenda (2015) (see in particular sections F and G): http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf

³⁵ For further information, see: Growing Inclusive Markets: <http://www.growinginclusivemarkets.org/>



UNEP Inquiry into the Design of a Sustainable Financial System

In 2015 UNEP published the first findings from its “Inquiry into the Design of a Sustainable Financial System,” initiated to explore options for realigning the global financial system with sustainable development. The report found that a ‘quiet revolution’ is already underway to integrate aspects of sustainable development into financial system reform, development and practice.

The Inquiry surveyed over 100 innovative measures across 15 diverse countries from China to Switzerland, India and Brazil, led by financial institutions and markets, regulators and policymakers. It showed that green bonds, green ratings and tighter sustainability reporting requirements on stock exchanges are some of the innovations financial markets have developed in recent years in response to a number of emerging signals including client demand for sustainable financial products.

At the national level, policymakers and regulators are helping to drive this process with measures to incentivize capital reallocation and enhance sustainability reporting. China’s Banking Regulatory Commission issued “Green Credit Guidelines” in 2012, requiring banks to report on environmentally-related credit risk in their lending activities. In France, the lead up to the COP21 climate change conference in December 2015, spurred new disclosure requirements obligating investors to include details of efforts to manage sustainability factors such as climate risks in their annual reports. In the United States, fiscal incentives, particularly tax benefits, are used to encourage increased financial flows into investments that deliver public goods. Collectively, these policy innovations inspired a set of five action points to amplify the revolution towards a global sustainable financial system summarized below.³⁶

While much more still needs to be done, these examples – and many more – show that efforts are underway at both national and international levels to put in place financial innovations, regulatory environments and other incentives to align much more finance with key public policy aims.

³⁶ UNEP, The Financial System We Need: Aligning the Financial System with Sustainable Development, October 2015: http://unepinquiry.org/wp-content/uploads/2015/11/The_Financial_System_We_Need_EN.pdf



Source: UNEP 2016



The 2030 Agenda and the Debt Sustainability Imperative

The 2030 Agenda will not be achieved in countries where debt becomes unsustainable. Excessively high debt service consumes export and other revenues which could otherwise fund investments in building productive capacities and reducing poverty. High debt can, in turn, increase borrowing costs as investors' perceive higher risk, leading to a vicious cycle of escalating debt and debt service costs.

Debt crises affect countries at *all* income levels, but can be particularly devastating for developing countries as the Latin American debt crisis of the 1980s and, more recently, the debt crisis of the Heavily Indebted Poor Countries (HIPCs) has revealed.³⁷

Much debt was restructured and/or written-down over the MDG period and debt "relief" is widely considered one of the most important MDG success stories. Under the Heavily Indebted Poor Countries (HIPC) Initiative, over US\$116 billion in debt (in present value terms) was cancelled for 42 of the world's poorest and most critically indebted countries.³⁸ While the HIPC Initiative had many problem features (e.g. its heavy conditionality burden), it nevertheless supported beneficiary countries to increase poverty reduction expenditures by, on average, 3 percentage points of GDP (pre versus post-relief) and is widely credited with reducing debt to more manageable levels.

Despite these successes, some countries nevertheless slipped under the radar. UNDP has, for example, documented the debt crisis that continues to face several small island developing states, particularly in the Caribbean.³⁹ Others are accumulating debt at a rapid pace (e.g. Lebanon and Cabo Verde). Some countries have simply replaced low-cost long-term external debt with high-cost short-term domestic debt accentuating debt vulnerabilities. The IMF has classified nine low-income countries as "at high risk" of debt distress and a further 24 "at moderate risk". Debt vulnerabilities therefore remain high across many developing countries.⁴⁰

It is clear that debt-funded projects must be carefully identified and implemented. The risks of poor project design and implementation are particularly high in the poorest countries. Lessons from previous debt crises also underscore how there has been an al-

37 For more information on the HIPC Initiative, see: World Bank: <http://www.worldbank.org/en/topic/debt/brief/hipc>

38 IMF and World Bank, Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Statistical Update (2016): <https://www.imf.org/external/np/pp/eng/2016/031516.pdf>

39 See: UNDP, Financing for Development and Small Island Developing States: A Snapshot and Ways Forward (2015): <http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/FfD-SIDS-UNDP-OHRLLS.html>

40 See: IMF: <https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf>



most universal over-optimism as regards commodity prices and the high-returns that large-scale costly infrastructure projects are likely to generate. Governments and international financial institutions have also tended to underestimate the long-term negative effects of major shocks. Careful debt management combined with improved debt restructuring modalities (where crises do occur) will be essential for realization of the SDGs. It should be noted that while an expanded pool of lenders can undoubtedly be helpful, it also makes debt restructuring more complex where repayment difficulties arise.⁴¹

On the positive side, there are a number of key new positive developments for improved debt prevention and management. These include the IMF and World Bank's debt sustainability framework for low- and middle-income countries (which monitors debt ratios and provides regular assessments as to countries' risks of over-indebtedness). This is combined with a strengthened focus on technical assistance by the Bretton Woods institutions to help countries develop debt strategies and manage their debt loads effectively. A broader suite of risk management products, such as weather and disaster insurance, local currency financing and countercyclical loan-type contracts (where debt service is allowed to fall to zero when a major economic or environmental shock occurs) also now exists. Where debt crises do strike, innovations such as "collective action clauses" (CACs) in bond contracts (where all bondholders are bound by law to accept the terms of a debt restructuring which is agreed by at least 75 percent of creditors) have been used to help coordinate creditors. Debt-for-climate swaps meanwhile have also been used in a few cases to raise resources for investments in environmental sectors (e.g. the Seychelles – see section three for further elaboration). Nevertheless, none of these is perfect and financing for development strategies must always keep debt sustainability at the fore and ensure debt is used constructively to fund high-quality productive investments.

⁴¹ Credit from large emerging economies such as China and Brazil is increasingly replacing credit from so-called 'traditional' Paris Club lenders, such as France, Germany and Japan and this trend is expected to continue and become more pronounced over the coming period.



A ‘Risk-informed’ Approach to Financing for Development: UNDP’s Approach

UNDP advocates for ‘risk-informed’ financing strategies and more systematic approaches to debt management. Various types of shocks and crises, including disasters caused by natural hazards, disease outbreaks, conflicts and economic shocks, can weaken a country’s debt sustainability. Instead of ad hoc and ex-post responses to debt distress following major shocks and crises (e.g. the grant assistance from the IMF to the Ebola-affected countries to pay-off future debt service payments), UNDP proposes increased use of state-contingent debt instruments, such as GDP-linked official sector lending and counter-cyclical lending contracts. These instruments, which aim to ex-ante and automatically trigger downward adjustments in debt service during shocks, have the potential to contribute to improve debt sustainability and help countries manage risk and cope with shocks more effectively.⁴²

⁴² For further resources on this subject, see: UNDP, Risk-Informed Finance for Development Can GDP-linked official lending to emerging economies and developing countries enhance risk management and resilience? (2015): <http://www.undp.org/content/dam/undp/library/Sustainable%20Development/Risk-Informed%20Finance%20for%20Development%20-%20July%207.pdf> and UNDP, Next time could be different – Towards risk-informed development finance (2015): <http://www.undp.org/content/dam/undp/library/Sustainable%20Development/FfD-Issue-Brief-RiskResilience.pdf> and UNDP, Financing the SDGs in the Least Developed Countries (LDCs): Diversifying the Financing Tool-box and Managing Vulnerability (2016): <http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/afd-undp-financing-sustainable-development-and-managing-vulnerab.html>



UNDP Mauritanie Oumou Sow
Fatimetou Mint Mohammed, 52, President of the Talhaya village cooperative in Assaba, Mauritania, receives seeds



**PART
TWO**



**Country Level
Support on Financing
for Sustainable
Development**



Introduction

What do these trends mean for UNDP's policy and programme support in the area of financing the 2030 Agenda, in particular at the country level?

UNDP's new Strategic Plan (2018-2021) is clear that countries at *all* income levels will need to successfully implement structural transformations to transition to low carbon economic development models to reduce poverty, protect the planet and sustain development progress. It outlines six key 'signature solutions' to orient the organization's work at the country level: 1) keeping people out of poverty; 2) strengthening effective, accountable and inclusive governance; 3) enhancing prevention and recovery for resilient societies; 4) promoting nature-based solutions for a sustainable planet; 5) closing the energy gap; 6) strengthening gender equality. Depending on each country's priorities, UNDP will work to help plan, prioritize, sequence and finance integrated policy and financing solutions to these complex challenges. It will also work to assess trade-offs, manage risk and uncertainty and strengthen long-term planning. The Strategic Plan is clear that UNDP should build on its core strengths, including:

- **UNDP as integrator:** UNDP's breadth of expertise and country presence makes it unique within the UN development system. UNDP has long-standing partnerships at the highest levels of government. Given this and UNDP's reputation as an impartial partner, UNDP effectively convenes across line ministries and development partners to promote 'whole-of-government' and 'whole-of-society' responses vital for transformational change;
- **UNDP as operational backbone.** UNDP's widespread country presence has also served as an operational platform for other UN agencies;
- **UNDP as a key partner of choice.** UNDP is a key partner to civil society, the private sector, international financial institutions and vertical funds, amongst other key development partners.

To deliver on these 'signature solutions' two platforms will be created:

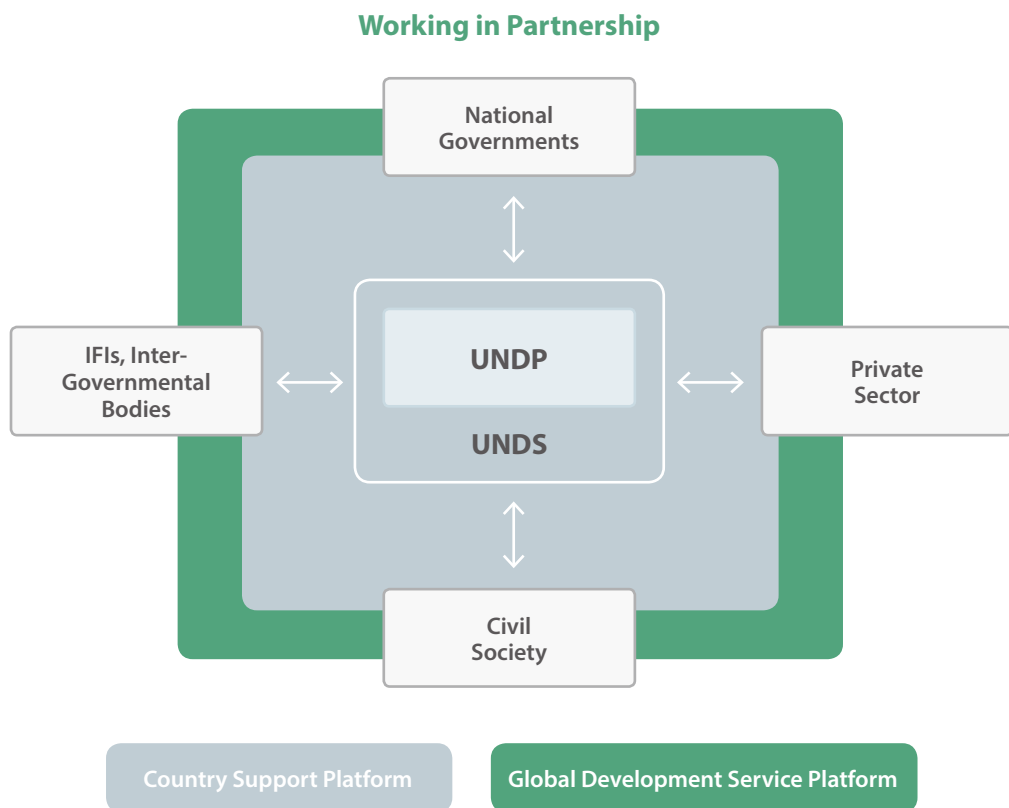
5. **Country Support Platforms:** to help countries design and deliver integrated solutions to complex development settings. It will consist of a core team trained in complexity and systems analysis, data systems and design thinking, backed by expertise on design finance, futures thinking and planning;



- 6. **Global Development Advisory and Implementation Services Platform:** to provide high-quality technical and policy advisory support to Country Platforms and UNDP's country programmes and support UNDP's knowledge, innovation and partnership-building efforts.

The Strategic Plan underscores UNDP's core strengths: as a connector and convener, policy advisor, service provider and innovator. UNDP's support on financing for development should play to these strengths and help countries to identify, plan and sequence various forms of finance, build partnerships between different actors to tap expertise and networks, make finance more effective and 'results' driven, and pilot innovations. This is where UNDP's 'value-added' lies.

UNDP's Approach: Two Platforms to Support Integrated Solutions for the 2030 Agenda



Source: UNDP Strategic Plan 2018-2021



UNDP has a track record to build on. For example:

- UNDP has supported many countries to carry out public expenditure reviews which provide guidance as to how budgetary resources may be most effectively deployed in support of development, especially in the environmental sphere;
- UNDP supports aid management and coordination schemes in many countries and is a key player in international aid and development effectiveness discussions;
- Through the Biodiversity Finance (BIOFIN) Initiative, UNDP has supported over 30 countries to develop biodiversity financing strategies;
- UNDP provides institutional and capacity development support to fiscal administrations that aim to build capacity to plan, budget, monitor and evaluate expenditures more effectively;
- Through the Tax Inspectors Without Borders (TIWB) initiative, jointly with the OECD, UNDP helps to build the capacities of tax administrations in the area of tax audits;
- UNDP has supported the development of the microfinance sector in a number of countries, jointly with the UN Capital Development Fund (UNCDF) in LDCs. This includes the creation and expansion of microfinance institutions and the development of new financial products to address national priorities (e.g. green, medium-size, gender-focused).
- UNDP supports countries to access climate finance from major international funds such as the Green Climate Fund, and to implement those projects;
- Through its climate, energy and biodiversity portfolios, UNDP has implemented a number of projects featuring innovative and more traditional non-grant financial mechanisms;
- UNDP has carried out Development Finance Assessments (DFAs) in 15 countries so far, which help authorities to analyze financing flows in their country and develop strategies for mobilizing new resources and making expenditures more effective.
- Environmental finance is an area where UNDP has developed a strong service line through its work with the vertical funds, and it may serve as a model for UNDP's approach in other development finance areas. This portfolio is managed by the UNDP Global Environmental Finance Unit (UNDP-GEF). The total UNDP-GEF portfolio under implementation covers 819 projects in 141 countries with US\$2.5 billion in grants, leveraging co-financing of a further US\$11.2 billion from domestic sources, the private sector and international financial institutions.
- UNDP has been successful in convening different investors active in the development space, e.g. impact investors, philanthropies etc. by creating spaces and new "platforms" for discussion and cooperation.



These service areas – and more – are documented in more detail in section three of this guidebook.

The aim of this section of the guidebook is to help country offices think about the different ways in which they can support countries to develop integrated financing for development strategies in support of the 2030 Agenda. While our role will change according to each country's circumstances and needs, examples include:

1. Support to help countries budget for the SDGs;
2. Improve governance and the management/coordination of different financing flows;
3. Help countries to responsibly innovate and expand access to the financing “tool-box”;
4. Facilitate access to international public and private finance flows, such as climate finance, impact investment and philanthropy etc.;
5. Support in project identification, costing and preparation, and the building of partnerships to support the implementation of priority interventions;
6. Help countries to identify and implement policy and regulatory reforms that may help them to harness particular financial flows;
7. Support international advocacy and share lessons learned.

The MAPS (Mainstreaming, Acceleration and Policy Support) Framework⁴³

At the centre of the UN development system's effort to support countries to implement the SDGs is the MAPS (Mainstreaming, Acceleration and Policy Support) framework, which outlines a common framework for UN development support at the country level. The MAPS framework is complemented by UNDP-specific tools such as the SDG Rapid Integrated Assessment (RIA) tool that aims to aid countries to assess their readiness to implement the SDGs, and the SDG Accelerator and Bottleneck Assessment Tool, which is designed to identify catalytic areas or “accelerators” that can trigger positive multiplier effects across the SDGs, and solutions to bottlenecks that impede the optimal performance of the accelerators.

⁴³ For further elaboration on the MAPS framework, see: UNDG, MAPS – Mainstreaming, Acceleration and Policy Support (2016): <https://undg.org/home/undg-mechanisms/sustainable-development-working-group/country-support/>



Securing technical advice and support on financing for sustainable development has been one of the core demands articulated by countries in the context of the UN's recent MAPS missions. The MAPS framework provides initial guidance to UN country teams around financing for sustainable development.⁴⁴ SDG implementation “roadmaps” which are an outcome of MAPS missions outline a series of priorities and initiatives that governments and their development partners can take in a variety of areas, such as SDG localization and prioritization, data and monitoring, and financing for sustainable development.

In the Armenia “roadmap” for example, the financing for development chapter looks at strategies to incentivize diaspora investment in the country, financing schemes to support local private sector development (SMEs), and projects that could be supported with impact investment. In Jamaica, the “roadmap” looks at the potential of blue bond and diaspora financing, as well as the importance of building the capacities of tax administrations.

1. Developing a Coherent Financing for Development Strategy: UNDP's Approach

UNDP's approach to financing for sustainable development is guided by three overarching principles:

1. **Efficiency:** public and private finance must be used catalytically. That is, to plan wisely, allocate resources for results and leverage multiple sources of finance.
2. **Effectiveness:** finance solutions should not be framed in silos. They should be combined to deliver multiple economic, social and environmental benefits and be risk-informed.
3. **Equity:** countries and people need to fairly participate and benefit. The financial market and the multiplication of financial flows have largely benefitted a fewer economies, sectors and groups.

These three principles should guide country teams' support for developing national financing strategies and plans, and piloting innovative financing approaches.

Secondly, UNDP has developed a 'structured approach' to providing country level support on financing for sustainable development. This 'structured approach' outlines four

⁴⁴ See Section 6B, “Budgeting for the Future” for further elaboration: UNDG, MAPS –Mainstreaming, Acceleration and Policy Support (2016): <https://undg.org/home/undg-mechanisms/sustainable-development-working-group/country-support/>

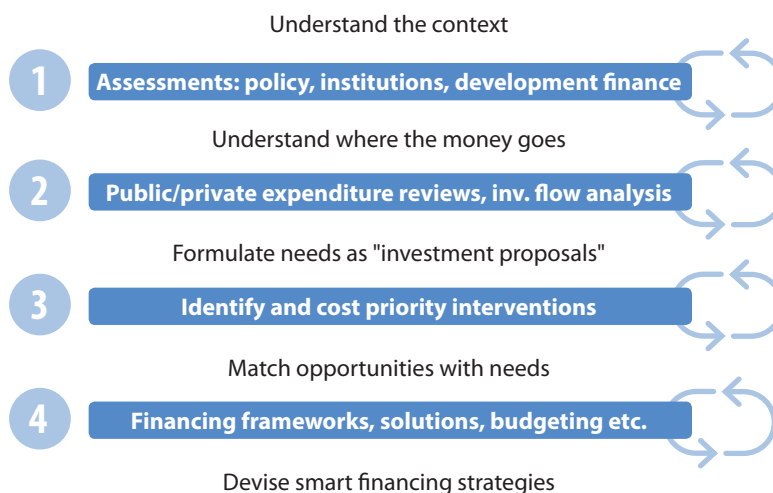


key steps country offices may wish to consider when providing country level support; one logically follows on from the other and they are based on the methodology used in the Biodiversity Finance (BIOFIN) Initiative (see box). The exercise should not be conducted in a vacuum but to be connected to a specific strategy, plan, investment pipeline or priority programme.

1. **Understand the context:** *undertake a mapping of different financing flows; review national/sectoral financing policies;*
2. **Public and private expenditure and institutional review:** *review the effectiveness of spending, the institutional arrangements and capacities for managing different financing flows;*
3. **Identify and cost priority interventions:** *build a project pipeline and cost key national/sectoral interventions, especially those that will have a 'multiplier' effect across several SDGs;*
4. **Devise national/sectoral financing strategy:** *identify and prioritize different financing 'solutions' and models in support of the SDGs.*

Countries may request UNDP assistance at any distinct step of a policy cycle, either with the planning and drafting of a financing strategy or investment pipeline, its execution, or at different phases of revision and refining; individual country circumstances and interests will differ. Experience has shown that success in mobilizing large investment flows require time, efforts and persistence – sometimes spanning several years or more. While short-cuts in analysis and the fast-tracking of individual financing initiatives (quick-wins) will all be extremely important, long term gains require thorough analysis, prioritization and the building of partnerships.

Financing for Sustainable Development: UNDP's Structured Approach





BIOFIN: the Biodiversity Finance Initiative

BIOFIN is a global partnership addressing the biodiversity finance challenge in a comprehensive manner. It has supported over 30 countries worldwide to measure their current biodiversity expenditures, assess their financial needs in the medium term and identify the most suitable finance solutions.

The initiative has developed an innovative methodology enabling countries to measure their current biodiversity expenditures, assess their financial needs in the medium term and identify the most suitable finance solutions to bridge their national biodiversity finance gaps.

The BIOFIN methodology comprises the following main steps:

- **Policy and Institutional Review:** Analysis of the policy and institutional architecture for biodiversity finance and existing finance solutions.
- **Biodiversity Expenditure Review:** Analysis of public and private expenditures affecting biodiversity.
- **Finance Needs Assessment:** Estimates the investment required to implement national biodiversity plans and achieve national biodiversity targets and results.
- **Biodiversity Finance Plan:** Analysis of options to optimize current and expand future investments (public, private, national, international, traditional and innovative) in biodiversity management.
- **Implementing Finance Solutions:** Support the implementation of policy recommendations emerging from BIOFIN, such as the improvement or creation of finance mechanisms and the integration of finance solutions into national planning cycles.

Source: BIOFIN⁴⁵

⁴⁵ See, BIOFIN: The Biodiversity Finance Initiative: <http://www.biodiversityfinance.net/>



2. Implementing UNDP's Structured Approach

2.1. Context Analysis (understand the context)

The first step is to analyze and understand the country context when it comes to current domestic and international financial flows and how these are spent vis-à-vis country development priorities.

This will involve a comprehensive review of: (i) current inflows (and outflows) in *volume* terms; (ii) domestic budget processes and allocations (e.g. by sector); (iii) allocations of *international* public and private finance flows; and (iv) national (and sectoral) development finance policies and plans.

This analysis is an important step in the development of any finance plan and will help to inform recommendations as to how countries can better align resources with the 2030 Agenda, leverage co-benefits across economic, environmental and social sectors, and mobilize and effectively manage new sources of funds.

The analysis should focus on the *quantitative* dimensions (e.g. *how much* is being raised from different sources and how the picture is *changing over time*), as well as how these relate to national development priorities. The following aspects might be considered (but are not exhaustive):

1. **Mapping** of the current **macroeconomic context and financial macro-indicators**, and analysis/**forward-looking projections** as to how different financing flows are likely to change;
2. Review of a country's **fiscal policy environment**, to assess fiscal space and the capacity to issue new debt obligations;
3. **Amounts** allocated to different sectors/issues from both domestic public resources and external public and private finance;
4. A review of **national policies** and strategies in the development finance arena (including **sectoral financing plans/strategies**, i.e. energy, environment, infrastructure etc. and also **policies to attract private financing flows**) and the extent to which these plans are being effectively realized (or are experiencing difficulties);
5. Analysis of how financing flows are **changing over time** (e.g. how has aid dependence changed over time and/or have the major development partners changed; how has international private investment evolved; how is this likely to change with graduation from e.g. LIC to MIC status, etc.);
6. Mapping **institutions** with key responsibilities in the budget cycle (planning, execution, monitoring, auditing etc.).



2.2. Public and Private Expenditure Reviews (understand where the money flows and how effective it is)

The second step is to understand a country's current public and private *expenditure* patterns and how they translate into sustainable development results, and are consistent with national development priorities. A public and private expenditure review may focus on government-wide expenditures or may focus on a particular sector (e.g. health, education, disaster management etc.). It focuses predominantly on *qualitative* aspects (e.g. to what extent are expenditures *effective* and do they translate into development *results*, budget delivery rates, volatility of allocations, distribution/concentration patterns etc.). Expenditure reviews have traditionally targeted public expenditures, but more recently surveys have also been conducted to estimate the expenditure of households and enterprises in selected areas such as disaster preparedness, climate changes and biodiversity. The analysis should also look at capacity within a country. The main objectives are:

1. To understand a country's current public expenditure patterns and how they translate into sustainable development **results**;
2. To understand **international** public and private finance flows, and their effectiveness/alignment with national development priorities;
3. To understand **decision-making processes** for translating national development plans into budget allocations and expenditures;
4. To analyze **institutional arrangements** for managing different domestic and international financial flows;
5. Understand a country's **capacity** (or capacity constraints) in the effective deployment of different sources of finance.

UNDP has developed the Development Finance Assessment (DFA) tool which can assist with steps one and two as outlined in this guidebook (see box for further elaboration). The DFA provides a country with an overview of the landscape of development finance, and the alignment of different finance flows to national development priorities and results. It outlines recommendations as to how different financing flows can be more effectively managed for development results.

UNDP also has substantial experience in carrying out public expenditure reviews. Most have been conducted in the area of environment, climate, biodiversity and water, with a more recent pipeline emerging on health and disaster risk reduction. Expenditure reviews are often conducted as one-off exercises, but can be easily integrated in the softwares used by financial authorities to manage and monitor budget allocations.

UNDP has conducted or is in the process of conducting more than 75 public expenditure reviews and is exploring carrying out assessments into private sector spending.



Similar to the BIOFIN Initiative, the “Governance of Climate Finance” project has produced helpful guidance material, including carrying out a Climate Public Expenditure and Institutional Review (see box), to budget tagging and the development of financing frameworks for climate.⁴⁶ With the advent of the SDGs, a few countries have started to link public expenditure reviews to the SDGs.

UNDP’s Development Finance Assessments (DFAs)

The Development Finance Assessment (DFA) is a tool that has been developed by UNDP’s Bangkok Regional Hub, now being rolled out globally, to support countries in taking more integrated approaches to financing national development priorities.

It is a country-level, context-informed assessment that that analyses financing needs and trends as well as the policy and institutional structures through which a government manages its financing policies.

It helps governments to identify priority challenges and opportunities for financing. The process is tailored to the country context under the guidance of a national oversight team comprising representatives of key government ministries and other institutions. It is designed to produce recommendations that are feasible within the country context and, through the nationally-led, consultative approach, and build consensus around these recommendations.

The DFA has been used by UNDP and governments in a number of countries to help establish roadmaps of reform that will support the development of more integrated approaches to finance their plans and vision. The DFA establishes these reform roadmaps around six building blocks of an Integrated National Financing Framework (INFF):

- **Institutional coherence for establishing and managing an INFF:** this includes leadership and political buy-in at highest level of Government, as well as institutional arrangements and coordination at various political, technical, and working levels;
- **A national development vision/plan with well-articulated set of priorities and results, including costed targets and indicators:** the costed results and targets will need to be articulated in long term, medium term, and annually;
- **An overall financing strategy that links national development results with sources of finance,** with attention to long, medium and annual results;

⁴⁶ For more information, see: <https://www.climatefinance-developmenteffectiveness.org/>



- **Financing policies for specific finance flows:** domestic public, international public, domestic private, international private;
- **A system for monitoring and evaluation of the effective use of finance for results,** in various time frames;
- **An enabling environment for accountability and dialogue** of the use of finance for results.

The DFA provides a country with an overview of the landscape of development finance, and the alignment of different finance flows to national development priorities and results. In particular, the DFA provides planning, finance and other ministries with data and analysis on changing trends in development finance. It also provides a set of recommendations on how policies and institutional arrangements for managing financing can be strengthened to support more integrated approaches to financing national priorities and results.

DFA's have been carried out in 26 countries across Asia-Pacific, Africa and Latin America and more are in the pipeline. Following the DFA, and building on its findings and recommendations, follow-up action-oriented support is provided to support strengthening overarching financing or sectoral strategies, policy/institutional reform, and capacity development or resource mobilization initiatives.

More information: <http://www.asia-pacific.undp.org/content/rbap/en/home/ourwork/democratic-governance-and-peacebuilding/ap-def.html>

The Climate Public Expenditures and Institutional Review (CPEIR)

CPEIR is a systematic qualitative and quantitative analysis of a country's public expenditures and how they relate to climate change. It presents evidence on public expenditures across all spending agencies. The definition of climate change related expenditures is tailored for each country based on a consultative process that takes into account its national priorities. In addition to reviewing and accounting for public expenditures, the CPEIR links the financial analysis with climate change plans and policies, institutional framework and public finance architecture in order to formulate recommendations to strengthen them.

A CPEIR can be a useful tool for national planning and budgeting, especially in terms of identifying and tracking budget allocations that respond to climate change challenges. Since 2011, CPEIRs have been conducted in many countries in Asia-Pacific, Latin



America and Africa. The analyses have been led by relevant government agencies, with technical assistance from UNDP and other development partners.

Examples of CPEIR led reform at the country level include:

- Budget marking and tagging in Nepal and Indonesia
- Climate fiscal framework in Bangladesh
- Climate change financing framework at both national and sub-national levels in Cambodia
- Focused sectoral analyses, building on previous CPEIRs in Cambodia and Thailand
- CPEIRs and similar studies were also conducted in Africa and Latin America

The Governance for Climate Change project implemented by UNDP Asia-Pacific contains a wealth of guiding material, data sources and best practices. UNDP in Latin America is planning a regional project to coordinate UNDP efforts in the region. The CPEIR is one component of the advisory services provided by UNDP on managing and accessing climate finance and should not be seen in isolation but attached to policy processes ultimately leading to the establishment of financing frameworks for climate and Nationally Determined Contributions.

Source: www.climatefinance-developmenteffectiveness.org

2.3. Identifying and Costing National Priorities and Building an Investment Pipeline

Once the broader financial and institutional picture for development finance is appraised, the second component of the assessment seeks to identify priority areas for intervention (with a particular focus on “acceleration solutions”), as well as cost these interventions.

Acceleration solutions can include financial interventions (e.g. step up investments in sustainable energy and/or climate change adaptation) as well as non-financial interventions (for instance strengthen institutional processes for the management of different kinds of finance). They can also include shorter-term or immediate measures (e.g. implement a new tax/alter an old one) and longer-term measures (e.g. strengthen domestic capital markets; build institutional capacity). Acceleration solutions are also those that seek to leverage co-benefits across social, environmental and economic domains (see box for further elaboration).

The assessment should “cost” those interventions as far as possible. Costing is a notoriously time-consuming and often technical exercise. It can be extremely difficult for



example to correctly estimate the cost of longer-term interventions. In addition, interventions that are not clearly described or specified cannot simply be costed. Detailed costing exercises often require a thorough review of very specific activities and projects contained in public development strategies.

Planners can also use different “rigour” and methodologies in cost estimations. For example, one approach is to cost interventions based on simple estimates derived from historical budgets, or on costs from similar actions in comparable geographical areas. More advanced costing models exist, for example in health (see box for further elaboration). High and low range cost estimates are usually needed, as well as assumptions and projections on macroeconomic variables such as inflation and exchange rates. To complicate matters, interventions in one area can leverage co-benefits or have harmful impacts in other areas. These should also be factored into the cost – and cost-effectiveness – of any intervention or project.

Costing: One Health Tool

The OneHealth Tool is a software designed to inform national strategic health planning. It links strategic objectives and targets of disease control and prevention programmes to the required investments. OneHealth provides a single framework for scenario analysis, costing, health impact analysis, budgeting and financing of strategies for all major diseases and health system components. It is thus primarily intended to inform sector-wide health plans and policies. Its application helps planners to answer the following questions:

- What are the health system resources needed to implement the strategic health plan (e.g. number of nurses and doctors required over the next 5-10 years)?
- How much would the strategic plan cost, by year and by input?
- What is the estimated health impact?
- How do costs compare with estimated available financing?

The development of the OneHealth tool is overseen by the UN InterAgency Working Group on Costing (IAWG-Costing) to which UNDP contributed. Since its release in May 2012, the tool has been applied in over 40 countries, mostly in sub-Saharan Africa.

Source: **World Health Organisation:** www.who.int/choice/onehealthtool/en/

Sometimes countries will have already attempted to identify and “cost” various priority projects or interventions, and these may vary in quality and/or be more or less up to date. These exercises help to make the economic case for increased resources for specific areas, as well as estimate the financing gap associated with those actions. This will in turn help planners to identify and prioritize potential financial mechanisms and strategies to fill those gaps.

UNDP has developed some tools to help identify and cost solutions. These include the BIOFIN Initiative; and UNDP’s co-financing methodology for health. These are covered in detail in Part three of this guidebook.



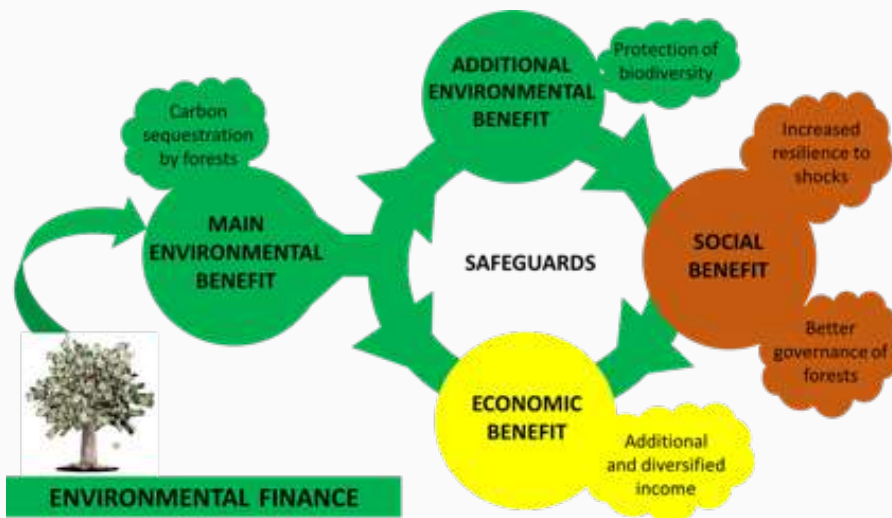
UN Photo Stuart Price

A shopkeeper is seen in a clothing and footwear shop in Hamar Weyne market in the Somali capital Mogadishu, 2013

Acceleration Solutions: Projects that Leverage Co-benefits Across Multiple Domains

Environmental finance can leverage not only multiple environmental benefits but can also trigger social and economic benefits. The diagram illustrates a project where carbon sequestration is the primary objective. In the example, this is achieved through the preservation of forests. This action produces immediate environmental benefits, which include biodiversity conservation and arresting land degradation. But it also generates social and economic benefits if, for example, communities living close to the forest are paid to protect their environment and are trained on how to establish sustainable business ventures (e.g. eco-tourism and sustainable harvesting of medicinal plants etc.). It can also foster more resilience to shocks, such as natural disasters and climate change through income diversification and soil stabilization. Safeguards connected to the disbursement of environmental finance can also ensure the rights of minorities or disadvantaged groups, for example indigenous groups are protected. Accounting for these multiple benefits means capturing both the environment and non-environment results through the implementation of a single measure or action.

Co-benefits: Environmental Finance and Development Benefits



Source: UNDP



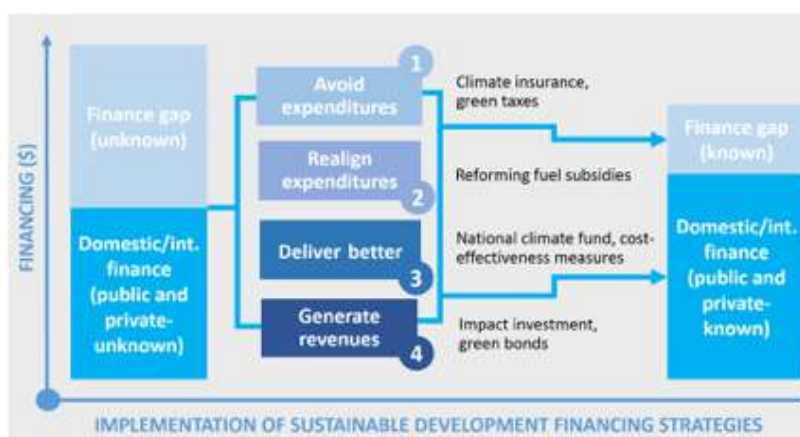
2.4. Developing a Financing Strategy

The final step is to formulate a national financing for development strategy or sectoral financing frameworks. Equally, financing plans/strategies can be formulated for a specific financing *flow* (e.g. a strategy to attract/deepen impact investment in a country).

What are the core elements of a financing for development strategy or plan? UNDP is encouraging country offices to think about financing for sustainable development, not just in terms of (new) resource mobilization (important though that is), but across four inter-linked areas. These are:

1. **Generate or leverage (new) resources for the SDGs**, i.e. any existing or innovative mechanism (e.g. impact investment vehicles, environmental taxes, etc.) that can generate and/or leverage *additional* financial resources for sustainable development.
2. **Realign current expenditures towards the SDGs**, i.e. any measure that can reorient *existing* financial flows towards the SDGs (e.g. climate sensitive budget reforms, or eliminating harmful subsidies).
3. **Avoid the need for future expenditures**, thus freeing up resources for investment in other areas, i.e. any measure that can prevent or reduce future investment needs by eliminating/amending existing counter-productive policies and expenditures (e.g. implementing taxes on sugar content or tobacco).
4. **Deliver financial resources more effectively**, i.e. any measure or strategy that can enhance cost-effectiveness/efficiency, synergies and/or favour a more equitable distribution of resources (e.g. strengthening public procurement).

This approach is based on our experience in the environmental finance domain and in particular the biodiversity finance – BIOFIN – programme. It shows that financing strategies involve both *direct* financial interventions (e.g. creation of a new tax) and also *indirect* financial interventions (e.g. regulatory reforms to attract new investment or improved coordination between line ministries to deliver resources more efficiently). The starting point is that the crafting of a credible finance plan cannot rely only on the mobilization of new revenues, but on a set of actions that can reduce future needs. Think for example about incentives and taxes that can shift consumer behaviours and reduce illness. Tobacco taxation and regulations can for example reduce the future health bill, with the same approach now being applied to sugar in some countries. In sum, if national and international development targets are to be achieved and financing gaps closed, only comprehensive strategies that also aim at reducing financial needs can be effective.



Source: UNDP

The relative importance of each of these four dimensions will however vary according to country context (e.g. some governments may have already taken important steps over recent years to improve and make more efficient public service delivery or to ensure aid donors better coordinate amongst themselves). The level of political commitment to one dimension versus another may also vary considerably (for instance some countries remain reluctant to invest in future risk-mitigation since future benefits are not easily quantifiable). Capacities to effectively execute budgets can be a challenge in some countries. Countries may also be interested in exploring new and innovative finance mechanisms such as impact investment or development impact bonds, but these can take considerable time to structure and put in place. In this context, it is clear that there are often “quick wins” or “low hanging fruits” when it comes to financing for development, whereas other measures may be politically more difficult or require substantial lead time. To be useful, financing support must therefore strike a careful balance between ambition and realism. It must also be grounded in a forward-looking analysis of both the trends in financing needs and the availability of different forms of financing. Debt sustainability must also remain at the forefront where financing options involve the use of debt-based instruments.

Financing plans should seek to explore, identify, assess and capitalize on a range of innovative and diverse financing solutions. Plans should explore which financing models and financing instruments may be most appropriate to meet particular needs, and should also define a clear roadmap for implementation. This may for instance prioritize a list of development finance flows to be developed in the next 5-10 years, and/or look at how specific financing models/approaches can be applied to priority interventions, and which partners should be involved. The aim is to support partner countries to identify, access and use diverse sources of finance in more strategic and catalytic ways.

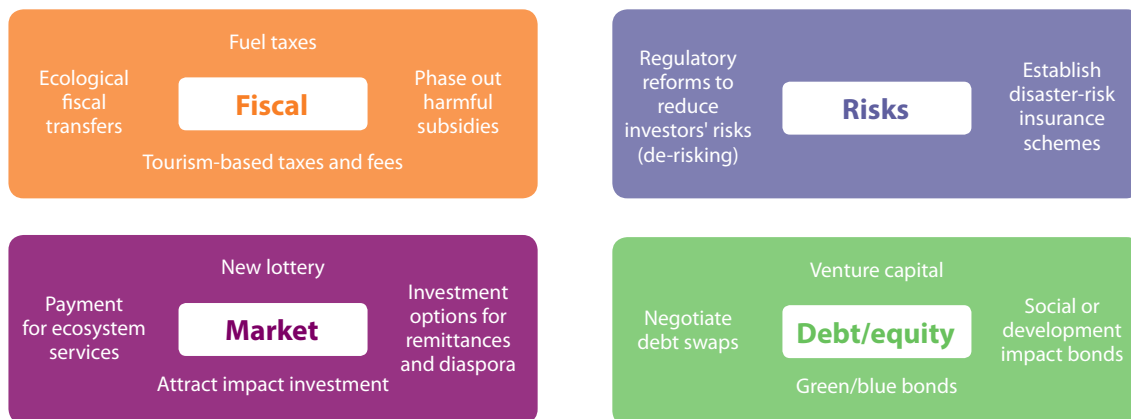


2.5. What are Possible Financing ‘Solutions’?

Financing “solutions” can be divided into six broad categories (where there are, in turn, overlaps between them):

1. Grants (transfers made in cash, goods or services for which no repayment is required);
2. Debt and equity (loans provided on concessional and non-concessional terms; investments in an asset);
3. Fiscal mechanisms (taxes, subsidies, fees etc.);
4. Market mechanisms (e.g. carbon markets);
5. Regulatory (policy and regulatory reform to reduce illicit outflows of capital and/or to attract private investment);
6. Risk management (e.g. guarantees, disaster-risk insurance etc.).

Financing Solutions



Source: UNDP



Source: UNDP

The usefulness and applicability of different financing instruments and approaches will depend on the country's chief aims with its financing strategy. The aim should be to identify and review a wide range of possible finance "solutions" and establish an agreed-upon approach for prioritizing some of them based on the characteristics of each financing "solution", including its financing potential, the legal context, expected socio-economic and environmental impacts, and any bottlenecks that may prevent its development/expansion (e.g. capacity constraints). For a selected number of the most promising financing mechanisms, a more detailed feasibility study should be carried out. So where a country wishes to deepen its domestic capital market, for example, instruments such as guarantees and local currently financing may be particularly useful and encouraged.

When devising a national financing strategy or plan it is also important to be mindful of "unintended" consequences. For example, it is not uncommon for countries to use incoming aid monies as a vehicle to reduce domestic budget allocations to a particular sector (e.g. health) so that overall expenditures on health do not actually increase (and indeed the sector may be rendered more vulnerable since aid flows are often more volatile and unpredictable than domestic resource allocations). In this respect, country teams should also consider any risks or limitations associated with different financing approaches, such as legal, regulatory, political or otherwise. UNDP's BIOFIN Initiative has developed a methodology for screening different financing options or 'solutions' against a checklist of key considerations (see box).



UNDP's BIOFIN Methodology

Screening financial mechanisms for biodiversity

In assessing the feasibility of each finance mechanism, planners can ask a series of questions to help screen potential finance mechanisms. These include:

Financial Considerations

- How much revenue will it generate?
- How stable and predictable is the revenue?
- What are the initial start-up costs?
- What is the return on investment both in terms of investment to revenue, as well as investment to natural capital increases?

Legal Considerations

- Is the mechanism legally feasible within the current system?
- Does it require new legislation, administrative rules, procedures or other types of legal changes?
- Is it possible to simply use an executive order to implement the mechanism?
- What kinds of legal liability might the mechanism create?

Administrative Considerations

- How difficult will it be to administer, enforce, collect and distribute revenue from the mechanism?
- Are there enough trained staff to implement the mechanism?
- What kind of training and support is required to implement the mechanism?
- What kinds of new technology might be required, and what are the training, investment and upgrade requirements of this technology?

Social Considerations

- What will be the intended and unintended social impacts?



- Who will pay for the mechanism?
- Who will benefit from the mechanism, including directly and indirectly?
- How will the benefits be distributed across key groups?
- Will the mechanism be viewed as equitable and will there be fair access to the mechanism?

Political Considerations

- Is there political will to create and implement the finance mechanism?
- Will the funds generated be redirected to the correct purpose?
- Is monitoring of the mechanisms politically and practically feasible?
- Are there any unintended political risks?

Environmental Considerations

- What are the intended and unintended environmental impacts involved in implementation?
- Can safeguards easily be put in place to predict and mitigate environmental risks?

UNDP's new online platform **"Financing Solutions for Sustainable Development"** can be consulted for more detailed summary explanations of different financial instruments and the opportunities and risks associated with each of them. It also carries useful case study examples.

3. Concluding Remarks

Nationally owned sustainable development strategies, supported by well-formulated integrated national financing frameworks, will be at the heart of the post-2015 agenda. The engagement of Finance and Planning Ministries and other line Ministries, as well as involvement of the private sector, civil society and development partners will be essential in these efforts. UNDP has a key role to play as a connector and convenor of different development partners and stakeholders. The SDGs demand that a broader range of both financing *sources* and financing *instruments* be used in more strategic and catalytic ways. Financing strategies should also encourage innovative approaches

and new partnerships. Ultimately however, implementation will depend on political will. It will also depend on capacity development and partner countries' abilities to understand different financing opportunities and risks. Development partners have a key role to play in capacity development, especially in low-income or post-conflict settings. Finally, as emphasized in the introductory section to this guidebook, inclusive, sustained (and sustainable) economic growth will underpin *all* countries' efforts to achieve the SDGs.



UN Photo Sophia Paris

1500 workers in UNDP's Cash for Work program get paid every 15 days at the Sant Triyaj Fatra in the Kafoufey neighborhood of Port-au-Prince



**PART
THREE**



**UNDP Tools, Policy
and Programme
Support on Financing
for Development**



Introduction

UNDP has developed a variety of services, publications, tools and programmes designed to support country teams on various aspects of financing for sustainable development. This section categorizes these tools and services by thematic area, though some cut across multiple areas.

1. Mapping and Analyzing Financing Flows

1.1. Development Finance Assessments

The **Development Finance Assessment (DFA)** is a UNDP tool that has been developed by UNDP's Asia-Pacific Regional Hub (Bangkok) to support countries to develop integrated national financing frameworks (INFFs). It is a country-level, context-informed assessment that provides data and analytical information on both quantitative and qualitative aspects of development resources in a country, and can be a useful tool for governments and their partners to identify opportunities and gaps in mobilizing financing and putting financing to more effective use. As such, it can help with steps one and two of the structured approach to finance outlined in this guidebook.

Expected results of the DFA (depending on country context) include: measurement of recent trends in development finance flows and their allocation to national priorities; an improved understanding of the roles and responsibilities of national institutions in managing individual financial flows; a set of recommendations as to how institutions and systems might be adjusted to ensure that different sources of development finance are managed within a coherent framework that better supports the achievement of national priorities and the SDGs.

DFAs have been carried out in Asia-Pacific and Sub-Saharan Africa, and more are in the pipeline (see figure). Following the DFA, and building on its findings and recommendations, follow-up action-oriented support is provided to develop an integrated national financing framework. This may entail deeper analytical work around specific thematic/sectoral areas, capacity building support, and implementation of specific financing solutions.



Website: <http://www.asia-pacific.undp.org/content/rbap/en/home/ourwork/democratic-governance-and-peacebuilding/ap-def.html>

DFAs Map the Financing Landscape in a Country Before Financing Solutions can then Be Evaluated

Phase 1

Development Finance Assessment

Develop a common understanding of the financing landscape and qualities of an Integrated National Financing Framework for sustainable development

Phase 2

Solutions for (financing) Results



Generate resources

Generate or leverage ODA, South-South Cooperation, international climate finance, vertical funds, impact investment



Realign resources

Prioritise and sequence investments, minimise negative expenditures, integrate and prioritise social and environmental expenditures such as through gender responsive budgeting, climate-related budget reforms, SDG-related budget reforms



Avoid future expenditures

Amend or eliminate counterproductive policies or expenditures; financing solutions include taxes on fuel, tobacco, and renewable natural capital



Deliver better

Favor a more equitable distribution of resources, prevent inefficiencies such as by strengthening public procurement risk mitigation, utilising solutions such as enterprise challenge funds, climate credit mechanisms, and biodiversity offsets



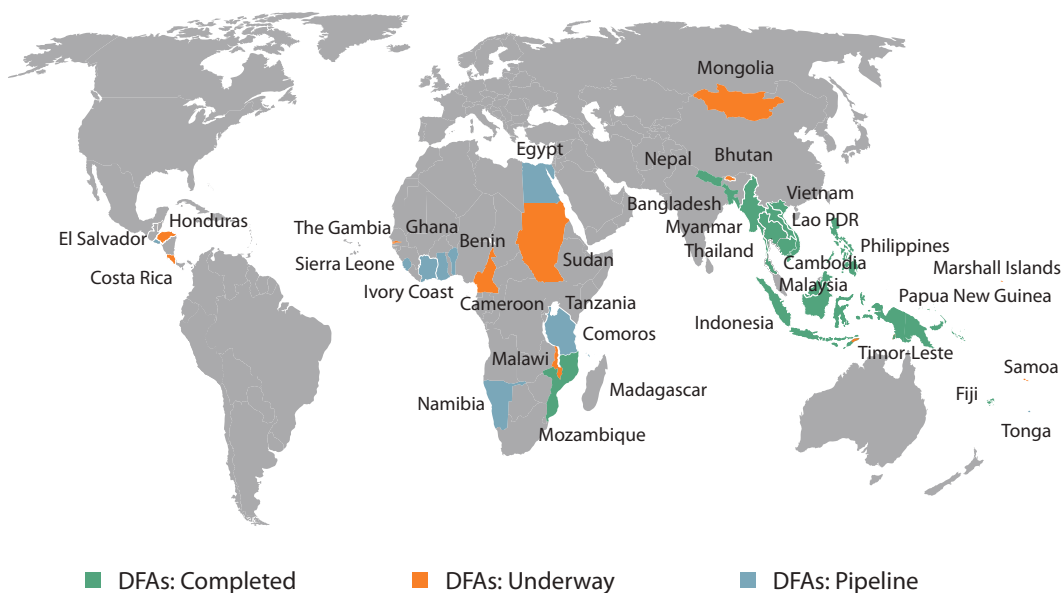
Strengthen transparency & accountability

Integrate Sustainable Development into Financial Management Information Systems, strengthen parliamentary oversight of the budget and other financial flows, engage with civil society, etc.

Source: UNDP



Where are Development Finance Assessments taking place now?



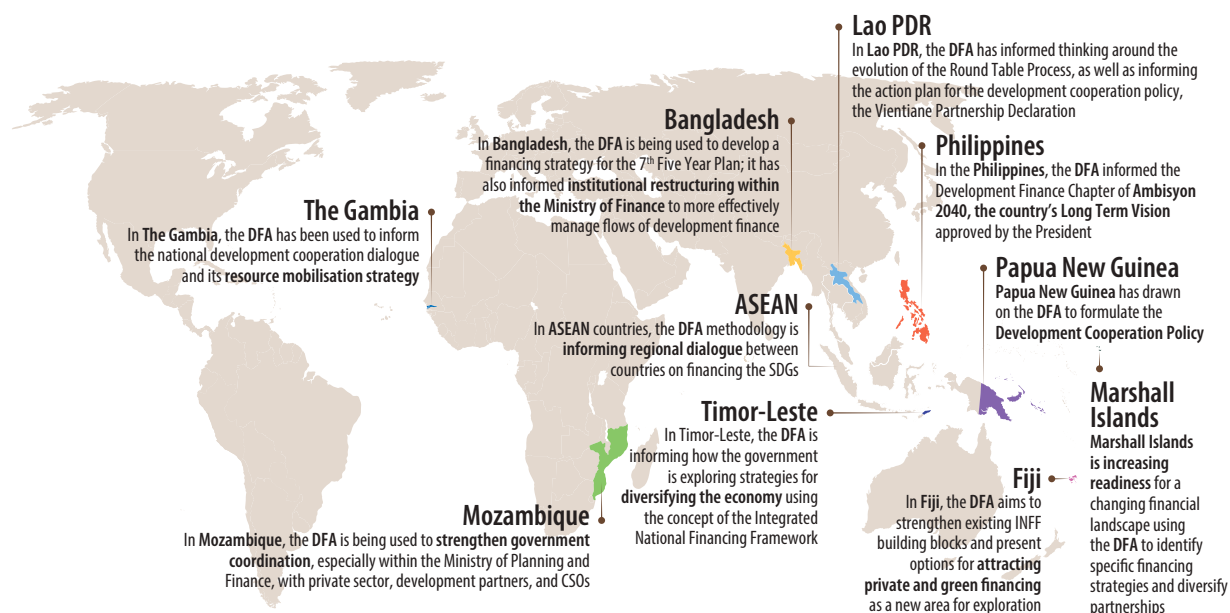
Source: UNDP



World Bank. Mohammad Al-Arief
 The Government of Madagascar provides more than 80,000 extreme poor households with access to safety nets through regular cash transfers while promoting nutrition, early childhood development, school attendance of children and productive activities of families



How countries have benefited from DFAs



Source: UNDP

2. Mobilization and Effective use of Domestic Resources for the SDGs

2.1. Budgeting for Agenda 2030 in Asia-Pacific

Agenda 2030 requires governments to work across ministries to leverage their resources behind common national priorities. Whilst budgets have traditionally been planned, executed and monitored by 'sector' ministries, the SDGs require budgets to be managed *across* ministries. This is especially the case with the SDGs that relate to poverty and inequality (1 and 10), gender (5), climate change (13), environment (15) and governance (16) for examples, but also to all SDGs.

UNDP has developed services to support governments in reforming their budget processes to take more integrated approaches to the SDGs. While other development partners are focusing on sector and systemic issues related to PFM reforms, UNDP is focusing its services on supporting government to work *across* ministries of finance, planning, line agencies and sub-national actors – particularly focusing on the cross cutting nature of SDGs.

UNDP services address the budget cycle at all stages with particular focus on budget formulation, monitoring and tracking and accountability for performance.



- i. **Public Expenditure and Institutional Reviews (PEIRs)** and other budget assessments are implemented to accelerate accountability and responsiveness of budgets for sustainable development. PEIRs identify the baseline of current allocations and expenditures in relation to particular issues of sustainable development and highlight the how the budget process can better prioritise investments. In implementing PEIRs, UNDP has generated significant experience in relation to issues such as climate change, disaster risk reduction, biodiversity and ecosystems, as well as non-communicable diseases. For example UNDP has supported Disaster Risk Reduction, Climate Change, Biodiversity, Child Health, Non-Communicable Diseases and Poverty related PEIRs in over 30 countries. Some countries have taken a more comprehensive approach to reviewing budget compatibility with the SDGs, such as in the Philippines.
- ii. **Budget tagging and accountability for the SDGs:** With UNDP support, a number of countries have established systems to tag and track sustainable development issues in the budget to facilitate greater responsiveness and accountability. Bangladesh, Indonesia, and Nepal have all established climate change, poverty and gender budget tagging systems and in Bangladesh there is work to look across social protection and climate change expenditures to track equity issues within climate change response.
- iii. **Systems for stronger budget prioritisation on the SDGs:** In Cambodia, Nepal, Pakistan and Thailand, work is underway to establish new budget guidelines that incorporate sustainable development concerns.
- iv. **Costing and financing frameworks for the SDGs as part of the budget process:** Cambodia, Bangladesh and Indonesia have established financing frameworks on climate change (SDG 13). In Bhutan and Thailand, projects have been established to develop an integrated financing framework for SDG1, 10 and 13 (poverty, climate and biodiversity).
- v. **New Sustainable Development Finance programmes:** UNDP is establishing reform programmes which look to mainstream cross cutting social, environment, economic and governance dimensions of sustainable development into budget formulation and reporting. One example of this in Indonesia.

2.2. Climate Public Expenditure and Institutional Review

Climate Public Expenditures and Institutional Review (CPEIR) is a systematic qualitative and quantitative analysis of a country's public expenditures and how they relate to climate change. It is an innovative tool that presents evidence on public expenditures across all ministries. The definition of climate change related expenditures is tailored for each country based on a consultative process that takes into account its national priorities. The CPEIR is an innovative methodology which in addition to the public expenditures of a country, also reviews its climate change plans and policies,



institutional framework and public finance architecture in order to make recommendations to strengthen them. A CPEIR can be a useful tool for national planning and budgeting, especially in terms of identifying and tracking budget allocations that respond to climate change challenges.

Since 2011, CPEIRs have been conducted in many countries in Asia-Pacific, including Bangladesh, Cambodia, Indonesia, Nepal, Philippines, Samoa, Thailand, and Viet Nam. The analyses have been led by relevant government agencies, with technical assistance from UNDP as well as other development partners.

UNDP together with the Overseas Development Institute (ODI) have developed a [Climate Public Expenditure and Institutional Review \(CPEIR\) Methodological Guidebook](#) which seeks to equip stakeholders (governments, donors, CPEIR practitioners) with information on a step-by-step process, methodologies and tools to conduct a CPEIR.

Website: <http://climatefinance-developmenteffectiveness.org/about/what-cpeir>

2.3. Tax Inspectors Without Borders

Tax Inspectors Without Borders (TIWB) is a joint initiative of the OECD and UNDP designed to support developing countries to build tax audit capacity. Tax administrations are on the frontline in the battle against tax avoidance. Estimates vary and are contested but cross-border tax avoidance impacting developing countries is likely to exceed ODA by a considerable margin. Tackling complex international tax arrangements that divert profits otherwise liable for corporate tax, calls for skilled tax auditors. A well-trained tax team can identify high-risk cases and uncover the arrangements that strip much-needed tax revenue from governments.

TIWB facilitates well-targeted, specialized tax audit assistance in developing countries around the world. Under TIWB, tax audit experts work alongside local officials of developing country tax administrations on tax audit and tax audit related issues. TIWB aims to transfer technical know-how and skills to developing countries' tax auditors, as well as share general audit practices. TIWB programmes can include: pre-audit risk assessment and case selection, investigatory techniques, audit cases involving transfer pricing issues, anti-avoidance rules, or sector-specific issues, relating for example to natural resources, e-commerce, financial services or telecommunications.

A dedicated central unit (TIWB Secretariat) jointly managed by the OECD and UNDP operates as a clearing house to match the demand for auditing assistance with appropriate expertise. TIWB assistance is delivered by current or recently retired tax audit experts who work full-time or periodically with the host administration.

It is currently running 27 programmes in 23 developing countries across regions, from Ghana to Georgia to Cambodia to Peru. It has already completed 3 programmes in 2



other countries. Two South-South programmes are currently running in Botswana and Uganda. The initiative complements the broader efforts of the international community to strengthen co-operation on tax matters.

TIWB assistance programmes have already resulted in an additional USD 328 million in tax revenues being mobilized. It is estimated that for every dollar spent on the initiative, developing countries can receive a return in excess of USD 1,000 from taxes recovered.

Website: www.tiwb.org



2.4. Capacity Building on Public Financial Management

Le Pole de Dakar

UNDP and France cooperate in the “Pole de Dakar” programme, an initiative that supports governments in French-speaking West and Central African countries to improve their public financial management capacities. The programme has 4 main objectives: 1) to strengthen countries’ capacities in development planning and macroeconomic policy-making; 2) to strengthen skills in multi-annual budgeting; 3) to strengthen monitoring and auditing skills; 4) to mobilize more domestic resources for development and to strengthen fiscal management. The programme also aims to support South-South Cooperation through the sharing of knowledge and experiences. It also offers on-line courses and material (in French) in areas such as budget preparation, auditing and the economy.

Website: <http://le-pole.org/>



3. Identifying and Costing Priority Interventions

3.1. The BIOFIN Initiative

Costing Biodiversity Financing Strategies and Actions: the BIOFIN Approach

UNDP's BIOFIN methodology outlines one approach for calculating the financial needs of implementing national biodiversity strategies and actions (commonly referred as NBSAPs) and to, where possible, assess the associated financing gap.

The 'Financial Needs Assessment' (FNA) aims to make a comprehensive estimate of the financial resources needed to achieve national and sub-national biodiversity targets. National biodiversity targets are typically articulated in NBSAPs and other key national strategies such as national development plans, sectoral development plans and climate change plans. The objectives of the FNA are to:

- Integrate needs assessment with the national planning and budgeting process for optimal impact.
- Convert strategies and actions in national biodiversity plans into “costable actions” that link to expected biodiversity results in a logical framework that lends itself to costing.
- Produce a detailed budget for each costable action by defining unit costs and quantities over the target time frame.
- Use these detailed budgets to make a stronger case for biodiversity finance – linking the costs of achieving specific results to national budget processes.
- Prioritize biodiversity strategies and actions based on specific biodiversity and cost criteria.
- Calculate where possible the finance gap between business as usual biodiversity expenditure projections and financial needs identified in the FNA in as detailed a manner as possible.

See: <http://www.biodiversityfinance.net/>

3.2. UNDP's “Co-financing” Methodology

UNDP has developed an innovative “**co-financing**” methodology that calculates the costs and benefits of interventions across sectors and weighs the values of the impacts to those participating sectors. It is a practical method for planners and budget holders to identify high value interventions that hit multiple targets, across different sectors at



once and to adequately pay for them. UNDP has piloted this co-financing methodology in the area of HIV, maternal health and social protection in 4 sub-Saharan African countries: Ethiopia, Malawi, South Africa and Tanzania.

UNDP's "Co-financing" Methodology: a Snapshot

Government ministries such as health, social welfare and education tend not to account for the multiple benefits of interventions when they evaluate programmes for cost-effectiveness. Successive evaluations of cash transfer programmes, for example, starting with the [Zomba trial in Malawi](#), provide strong evidence that small monthly cash transfers not only keep girls in school, thus benefiting the education sector, but prevent unwanted teen pregnancies (an important health outcome) and reduce HIV transmission by around two thirds.⁴⁷ As the values of the impacts (e.g. girls remain in school, HIV infections averted, unwanted pregnancies averted) accrue across multiple sectors, the willingness to pay of each benefiting sector is usually less than the cost of the intervention. Hence the intervention remains undervalued and lacks investment.

The method encourages different sectors to pool their resources together to fund mutually beneficial structural interventions. Specific contributions are determined by each sector's willingness to pay for anticipated results. Splitting the bill for structural interventions fairly across sectors can save governments money while salvaging impacts from high-value programmes that would otherwise go unfunded. Cross-sectoral co-financing does not require *de novo* monetary inputs – rather, it achieves a more efficient allocation of countries' *existing* resources, and a [better, more accurate economic evaluation](#) of structural interventions. The status quo alternative to cross-sectoral co-financing – continuing to spend in siloes without accounting for structural interventions' full range of costs and benefits across sectors – would miss a major opportunity to make progress across the SDGs by investing more efficiently.

UNDP has introduced the co-financing approach to senior-level cross-ministerial delegations from four sub-Saharan African countries: Ethiopia, Malawi, Tanzania and South Africa. UNDP is now supporting these domestic governments to translate the methodology into high impact, cost-effective programming and financing structures.

⁴⁷ Taken from: UNDP, Co-financing for health and development – an affordable innovation (2015): <http://www.undp.org/content/undp/en/home/blog/2015/7/13/Co-financing-for-health-and-development-an-affordable-innovation.html>



4. Leveraging Finance from the Private Sector for the SDGs, Including Through Innovative Financing

4.1. UNDP SDG Impact Finance

UNDP's SDG Impact Finance Initiative (UNSIF) is a new co-investment platform where the public sector and private sector can leverage new financing models and partners to create both economic and social returns. As the development finance environment changes, UNDP-UNSIF facilitates the transition from grant-only project-based development to a more scalable blended financed market-based development that leverages the capital market and philanthropic funds to finance SDG-aligned investment projects.

UNSIF leverages institutional investors and private wealth in the following ways:

- By facilitating social impact investments to support national development priorities in key areas such as poverty reduction, job creation, affordable and clean energy, industry innovation and infrastructure, sustainable cities and communities and climate change;
- Certifying SDG-aligned impact investments to de-risk, quality assure and prepare social impact projects along rigorous social, economic and environmental standards, building on UNDP's work on environmental and social screening standards as well as its gender seal;
- Building on UNDP's South-South Cooperation strategy and corporate partnership initiatives, facilitate project pipeline development, research and advocacy for up-scaling impact investing for the SDGs, resulting in a robust pipeline of SDGs projects which attract investor funding.

Website: <http://undp.socialimpact.fund/>

4.2. SDG Philanthropy Platform

The Sustainable Development Goals Philanthropy Platform (SDGPP or the Platform) is a global initiative that connects philanthropy with knowledge and networks that can deepen collaboration, leverage resources and sustain impact, driving SDG delivery within national development agendas.

Established as a global facilitator that enables strong partnerships between philanthropic organizations, the United Nations, governments, civil society, businesses, and other stakeholders, SDGPP is led by the United Nations Development Programme (UNDP) and Rockefeller Philanthropy Advisors (RPA) and supported by the Conrad N. Hilton Foundation, Ford Foundation, Brach Family Charitable Foundation, and UN Foundation.



To date, the Platform has brought together over a thousand philanthropists across various countries to facilitate effective collaboration so that together, funding and programmes have a greater and more sustainable impact on people's lives.

Also, SDGPP has established pathways to engage philanthropy in national SDG planning and implementation in eight pilot countries, namely Brazil, Colombia, Ghana, India, Indonesia, Kenya, the US and Zambia, and is currently seeking to expand to many others. The Platform has recently launched a new interactive portal – www.sdgphilanthropy.org – which serves as an SDG resource hub and a marketplace to support initiatives, and ideas for philanthropists, foundations, governments, the UN, and social innovators. By providing this online space to connect and collaborate with the philanthropic community under the shared mission of SDGs, the website helps reduce duplication of efforts and leverage resources, increase transparency, facilitate information-sharing, and highlight philanthropy's essential role in global implementation efforts.

Website: <http://sdgfunders.org/>

4.3. Global Islamic Finance and Impact Investing Platform

The **Global Islamic Finance and Impact Investing Platform** was established in 2016 by the Islamic Development Bank and UNDP's Istanbul International Centre for Private Sector in Development (IICPSD), and aims to position Islamic finance and impact investing as a leading enabler of SDG implementation. It serves as a knowledge hub for peer-learning and experience sharing, a forum for policy dialogue and advocacy, and a marketplace for impact investment.

The platform aims to promote market-based solutions to sustainable development challenges by creating a collaborative working space among these actors. Core activities of the platform are based on a three-pillar strategy:

1. **Conceptualization & Capacity Building:** Maintain a network of Islamic finance impact investors to foster an Islamic finance and impact investing ecosystem. Knowledge products, tools and data will aim to equip its members from the impact investment industry and the Islamic finance industry with the necessary know-how for the establishment and growth of this new niche industry.
2. **Advocacy & Inter-industry Collaboration:** Engage in advocacy to raise awareness on the compatibility of Islamic finance and impact investing and their capacity to implement the SDGs, and build bridges between Islamic finance and impact investing.
3. **Deal Sourcing & Matchmaking:** Play a matchmaking role between investors and other players in the ecosystem such as business incubators, development organizations and most importantly, inclusive business ventures seeking capital. Such functions significantly reduce the time, effort and costs involved in due diligence and helps overcome information barriers to investors.



More information: http://www.iicpsd.undp.org/content/dam/istanbul/docs/IslamicFinance_BroWEB.pdf

4.4. Impact Investment in Africa

UNDP's RSCA (Regional Service Centre for Africa) in partnership with African Union has over the last 2 years carried out research to understand impact investment in Africa and explore potential opportunities for its mobilization in support of Agenda 2063 and SDG implementation. Initially, a knowledge product was published entitled '**Impact Investment in Africa**' looking at the trends, constraints and opportunities for the sector on the continent.⁴⁸

The first ever Public Private Dialogue was held in late 2015 leading to the adoption of the "Cape Town Africa Impact Investment Declaration". This document directs UNDP to work with key regional stakeholders including interested African Governments, Impact Funds, Social entrepreneurs, institutional investors, Development Finance Institutions (DFIs), other sector intermediaries, and service providers to operationalize a detailed action plan for the development of the impact investment sector in Africa.

UNDP's Addis Ababa Regional Hub is seeking to develop '**Impact@Africa**', a platform to coordinate and promote impact investment in Africa by convening key players.

4.5. UNDP Innovation Facility

Through **UNDP's Innovation Facility** (established in 2014), a small number of 'alternative finance' small-scale experiments have been funded at country level (e.g. a development impact bond in Serbia and a diaspora bond feasibility study in Cabo Verde). The Innovation Facility also supported the establishment of the Alternative Finance Lab (**AltFinLab**) (established 2016), an internal start-up to explore and tap into new financial technologies and mechanisms. They also established the Global Crowdfunding Academy, which has provided advice and guidance to more than a dozen UNDP crowdfunding campaigns, mobilized several hundred-thousand US\$ and is exploring equity and loan crowd-investments in renewable energy sources.

Website: <http://www.undp.org/content/undp/en/home/ourwork/development-impact/innovation.html>

⁴⁸ UNDP, Impact Investment in Africa: Trends, Constraints and Opportunities (2016): http://www.undp.org/content/undp/en/home/partners/private_sector/AFIM/impact-investment-in-africa-trends--constraints-and-opportuniti.html



5. Environmental Finance

The UNDP Global Environmental Finance (UNDP-GEF) Unit partners with environmental vertical funds to support countries to reduce poverty and inequalities, by catalyzing environmental finance for sustainable development. The Unit provides programming and implementation support services to countries in the sustainable management of ecosystem goods and services; scaling-up of climate change adaptation and mitigation; sustainable, affordable and accessible energy services; sustainable management of chemicals and waste; and improved water and ocean governance. The Unit manages a number of innovative finance schemes from financial aggregation facilities for renewable projects, to a biodiversity microfinance downscaling mechanism to development impact bonds. Some are profiled below.

5.1. Biodiversity Finance Initiative (BIOFIN)

BIOFIN is a global partnership addressing the biodiversity finance challenge in a comprehensive manner. The Initiative provides an innovative methodology enabling countries to measure their current biodiversity expenditures, assess their financial needs in the medium term and identify the most suitable finance solutions to bridge their national biodiversity finance gaps. There are currently 31 countries globally participating in BIOFIN. The project, which began in 2012 and continues through 2018, is coordinated by the UNDP through a global team supporting country implementation and the continuous improvement of the BIOFIN methodology. At the regional and global level, BIOFIN enables participating countries to exchange experiences through a variety of South-South cooperation mechanisms such as regional and global workshops, the BIOFIN website, dedicated webinars and other platforms.

Website: <http://www.biodiversityfinance.net/>

5.2. Derisking Renewable Energy Investment

Derisking Renewable Energy Investment (DREI) introduces an innovative framework to assist policymakers in developing countries to cost-effectively promote private sector investment in renewable energy. The DREI framework systematically identifies the barriers and associated risks which can hold back private sector investment in renewable energy. It quantifies how risks are priced into higher financing costs. It then assists policymakers to put in place packages of targeted public interventions to address these risks.

Each public intervention acts in one of three ways: by *reducing*, *transferring* or *compensating* for risk. The overall aim is to cost-effectively achieve a risk-return profile that catalyzes private sector investment at scale. The end objective is reliable and affordable renewable energy solutions in developing countries.



Available at: www.undp.org/DREI

5.3. The Climate Aggregation Platform (CAP)

The Climate Aggregation Platform (CAP) seeks to promote and scale-up financial markets for asset-backed securities in small-scale, low-carbon energy assets. With initial seed financing of US\$ 2 million from GEF, UNDP partners with the Climate Bonds Initiative in its implementation. Development banks are providing co-financing to the project (e.g. the Inter-American Development Bank (IDB) is providing US\$50 million in co-financing). The project applies an innovative finance approach to energy markets, where countries are transitioning from centralized to decentralized systems. The project's value proposition is on awareness raising, knowledge management and working groups globally and is centered around a concrete showcase transaction in pilot countries.

Environmental Finance Tools: a Guidebook

UNDP has produced an **International Guidebook of Environmental Finance Tools** that provides planners with information on developing and implementing the most commonly used, widely applicable and potentially high-impact environmental finance tools. These include finance mechanisms such as: fees (e.g. community forest fees; entry or departure fees); environmental-focused loans (from multimillion-dollar World Bank investments in national energy projects to microfinance programmes that offer small loans to individuals); payments for eco-system services and market-based mechanisms; clean development mechanism and voluntary emissions reductions; subsidies; and environmental taxes. UNDP's guidebook explores countries' experiences with these various tools, explores their revenue potential and possibilities for scale as well as how easy the solution is to implement.⁴⁹

Available at: http://www.undp.org/content/undp/en/home/librarypage/environment-energy/environmental_finance/international-guidebook-of-environmental-finance-tools-.html

⁴⁹ UNDP, International Guidebook of Environmental Finance tools (2012): http://www.undp.org/content/undp/en/home/librarypage/environment-energy/environmental_finance/international-guidebook-of-environmental-finance-tools-/



6. Expanding South-South Cooperation

6.1. SSMart for SDGs

South-South Cooperation providers will play an increasingly important role in the financing of the 2030 Agenda. UNDP's main role in South-South Cooperation (SSC) is to act as a knowledge broker and to help in the formation of new partnerships between countries.

In 2016, UNDP launched '**SSMart**' for Sustainable Development Goals, a global marketplace that provides an entry point to South-South cooperation, fostering real-time exchanges of solutions demanded and supplied by developing countries to address challenges in achieving the SDGs.

How does SSMart for SDGs Work?

- It encourages partners to share solutions, post their demands and proactively seek collaborative opportunities and partnerships in order to create a vibrant marketplace of ideas, expertise, knowledge and technologies.
- It helps partners assess demands and facilitates collaboration between partners seeking a solution and partners sharing a corresponding solution.
- It provides advisory services to partners, including resources and expertise for feasibility studies, adaptation of solutions for a specific context, project implementation, monitoring and impact assessments.

The SSMart is an inclusive, multi-stakeholder platform, for all actors working towards the achievement of the SDGs: Governments, civil society organizations, the United Nations Development System, international financial institutions and the private sector.

Website: <http://global-smart.org/>

6.2. South-South Global Thinkers: the Global Coalition of Think Tank Networks for SSC

UNDP and the UN Office on South-South Cooperation (UNOSSC) are jointly supporting the establishment of the [South-South Global Thinkers: the Global Coalition of Think Tank Networks for SSC](#), in partnership with various Southern-led think tank networks and private sector entities. The initiative aims to provide an enabling environment for think tank networks from the South and also from the North to produce and share relevant knowledge for sustainable development and scale up the impact of SSC and TrC in the implementation of the SDGs. The research, knowledge and policy generated from the project will inform global policy dialogues on SSC. The Coalition aims to contribute to the following:



- Build partnership with major think tank networks to deepen the understanding of SSC and TrC, including its concepts, methodologies, policy issues and solutions for sustainable development;
- Facilitate a global support platform that connects and enable various networks of Think Tanks and centres of excellence, to exchange knowledge, pool multidisciplinary expertise, and collaboratively conduct research and policy dialogues on scaling up SSC and TrC for sustainable development.
- Support capacity development of think tank networks to provide data informed analysis and advisory services to inform policy making and practice in SSC and TrC to accelerate progress in the implementation of the 2030 Agenda through SSC and TrC.

Website: <https://www.ssc-globalthinkers.org/>



UNDP Andres Martinez Casares
Women working in the CARMEN House self-repair Project



7. Global Advocacy on Financing the SDGs

7.1 Monitoring Progress Towards the Addis Ababa Action Agenda: the Financing for Development Follow-up Process

UNDP is one of five institutional stakeholders for the Addis Ababa financing for development follow-up process.⁵⁰ UNDP is mandated to collaborate with the other agencies in the preparation of an annual report that monitors countries' compliance with the commitments set out in the Addis Ababa Action Agenda (AAAA). This group is called the Inter-Agency Task Force. UNDP also supports the annual FfD Forum held every year in New York in the spring which is an opportunity for Member States to discuss progress on financing for development and resolve areas where progress remains difficult.

The annual report covers the different thematic chapters of the AAAA, namely: domestic public resources; private finance; international public finance and ODA; debt sustainability; international trade; systemic issues; cross-cutting issues; technology, and; data, follow-up and monitoring. UNDP takes the lead in drafting and/or contributes to several of these chapters. The 2016 report on AAAA outlined a framework for measuring and reporting on countries' compliance with the AAAA.⁵¹ The 2017 report uses data and case studies to illustrate progress towards key financing for development commitments.

This process may be of interest to country offices for three reasons. First, the website contains a comprehensive repository of data and information on development finance flows and trends; second, it provides an opportunity for UNDP to profile case studies and examples of where countries and their development partners are having key successes in accessing or deploying various forms of development finance; finally, it can help generate political momentum in areas where progress on development finance may be weaker, built on empirical evidence.

Website: <https://developmentfinance.un.org/>

⁵⁰ The other five institutional stakeholders are: UNCTAD, the IMF, World Bank and WTO. The overall process is coordinated by UN DESA's Financing for Development Office.

⁵¹ The 2016 report of the Inter-Agency Task Force is available at: <http://www.un.org/esa/ffd/ffd-follow-up/inter-agency-task-force.html>

7.2. Global Partnership for Effective Development Co-operation (GPEDC) and Monitoring of Effective Development Cooperation

UNDP together with the OECD supports the Global Partnership for Effective Development Cooperation (GPEDC) as the OECD/UNDP Joint Support Team. The GPEDC is an inclusive multi-stakeholder partnership forum focused on improving the effectiveness of all forms of development cooperation. The GPEDC supports partners to: (1) generate evidence on progress and challenges in making development cooperation more effective through the GPEDC monitoring framework; (2) facilitate dialogue and mutual learning among partners on how progress can be made to maximize the impact of their development cooperation; and: (3) promote political momentum for effective development cooperation.

The GPEDC monitoring exercise tracks progress in the implementation of effective development cooperation principles through a set of 10 indicators. These indicators include: quality and use of country results framework; enabling environment for civil society; public-private dialogue; transparency of information on development cooperation; predictability; development cooperation reported on-budget; mutual accountability; gender equality and women's empowerment; quality and use of country systems; and untying of aid. The monitoring is undertaken at country level under the government's leadership through an inclusive multi-stakeholder review and dialogue.

For more information, see: <http://effectivecooperation.org/>





**PART
FOUR**



**Financing Solutions
in Focus**



Financing Solutions in Focus

This section outlines the main features of some of the most widely-known and well-used financing instruments or ‘solutions’, including innovative new financial models. It describes their core uses and aims, and also summarizes their advantages and limitations. Case studies illustrate how and where different financing instruments have been used successfully.

For information on other key financing instruments not covered by this guidebook, see **UNDP’s online Financing Solutions website**.

1. Blended Finance⁵²

Interest in ‘blended’ finance has mushroomed over recent years and it is one of most dynamic fields in the financing for development arena. A host of actors are now involved in blended finance, from bilateral development agencies to multilateral development finance institutions and philanthropic foundations. Many are also keen to expand their activities in this arena; they see in blended finance an opportunity to scale up both public and private financing for developing countries in an overall context where public resources for development are constrained.

There is no universal definition of ‘blended finance’ but it is broadly understood as the strategic combination of public and/or private development finance flows (e.g. aid and philanthropic funds) with other public or private capital to enhance resources for investment in key areas such as infrastructure. Blended finance can therefore involve public-public financial partnerships as well as public-private partnerships.

The rationale behind blended finance is threefold: (i) to increase capital leverage (aid and philanthropic funds are used to attract/mobilize additional public or private capital); (ii) to enhance impact (the skillset, knowledge and resources of public and private investors combined can increase the scope, range, and effectiveness of the project), and (iii) deliver risk-adjusted returns (manage risks so that returns are in line with market expectations).

⁵² Extracted and adapted from: UNDP and AFD, Financing the SDGs in the Least Developed Countries (LDCs): Diversifying the Financing Tool-box and Managing Vulnerability (2016): <http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/afd-undp-financing-sustainable-development-and-managing-vulnerab.html>



The “grant” or “aid” element in blended finance packages can be used in a variety of ways. This includes: technical assistance (e.g. for project preparation services, and to provide advice/training to public or private investees to lower transaction costs); risk underwriting (to fully or partially protect the investor against various forms of risk); market incentives (to provide guaranteed future payments to investors in exchange for upfront investment in new or distressed markets, or to stimulate innovation around new products or services).

For instance, the aid agency-backed Infrastructure Project Preparation Facility (IPPF) managed by the African Development Bank (AfDB) provides grants for infrastructure project preparation activities in Africa. By funding project preparation studies and technical advisory services, IPPF has helped to catalyze public and private financing for critical infrastructure development in energy, water, transport, and information and communication technologies (ICT). Public investors can also participate in blended finance transactions by providing equity or debt financing at market rates and terms, and in many cases, below-market rates and/or terms to incentivize private finance. Leading development finance institutions engaged in blending include the European Investment Bank (EIB), the European Commission, the French Development Agency (AFD) and the German development bank (KfW).

Much blended finance has been used to support investments in infrastructure development. The European Commission has used blending facilities for example to fund projects in the fields of: energy (35 percent), transport (26 percent), water (20 percent), support to SMEs (small and medium-sized enterprises) (11 percent), the social sectors (5 percent), and ICT (3 percent).

Examples of the EU’s blended financing facilities include the EU-Africa Infrastructure Trust Fund (EU-AITF), the Asia Investment Facility (AIF) and the Investment Facility for the Pacific (IFP). They aim to increase investment principally in infrastructure by blending grants with long-term loans from participating public or private financiers. Grants from these blending facilities can take four different forms: technical assistance to help with the preparation and management of projects; interest rate subsidies; direct grants or investment grants to finance a project component (equipment or services); financial instruments, such as loan guarantees, insurance premiums and equity or quasi-equity investments or other risk-sharing instruments.

Despite the potential of blended finance to significantly scale-up resources for sustainable development (in particular in the infrastructure sector) there are also a number of challenges and constraints. Finalizing a blended finance package deal takes time – on average much more time than the disbursement of grant simply because of the number of financing instruments and institutions/entities involved. Other constraints include limited knowledge and awareness of such instruments and programmes, as well as limited technical capacities to structure, manage and execute these types of arrangement in ways that take into consideration the social and environmental impacts of the projects. These are present on both on the supplier side (i.e. within development finance institutions) as well as on the recipient side (i.e. within developing countries).



The experiences with public-private partnerships in financing infrastructure have so far been mixed, especially in contexts where transactions were arranged in ways in which the public financing/risk went beyond initial expectations, resulting in a net transfer of public resources to subsidize private investors.

Some institutions and analysts have also urged significant caution when it comes to recommending less-concessional finance for developing countries, and in particular low-income countries where debt sustainability may be a concern and where capacities to negotiate and mobilize the best financing, identify and implement high-return investment projects which target diversification and value-added are weaker.

Blended finance and public-private partnerships offer the potential to use public resources to leverage additional capital and share risk, but are often complex to arrange in ways that serve the public interest. This happens everywhere, but it is particularly important to ensure that capacity exists to negotiate and structure these financing arrangements in developing countries. Information asymmetries between national authorities in developing countries and international investors, in particular, can lead to biased outcomes in favour of private investors. Thus, it is important to ensure that along with the promotion of blended finance, conditions are put in place to support countries to negotiate appropriate deals, and continuously invest in capacity to enable them to negotiate, monitor and expand these arrangements.

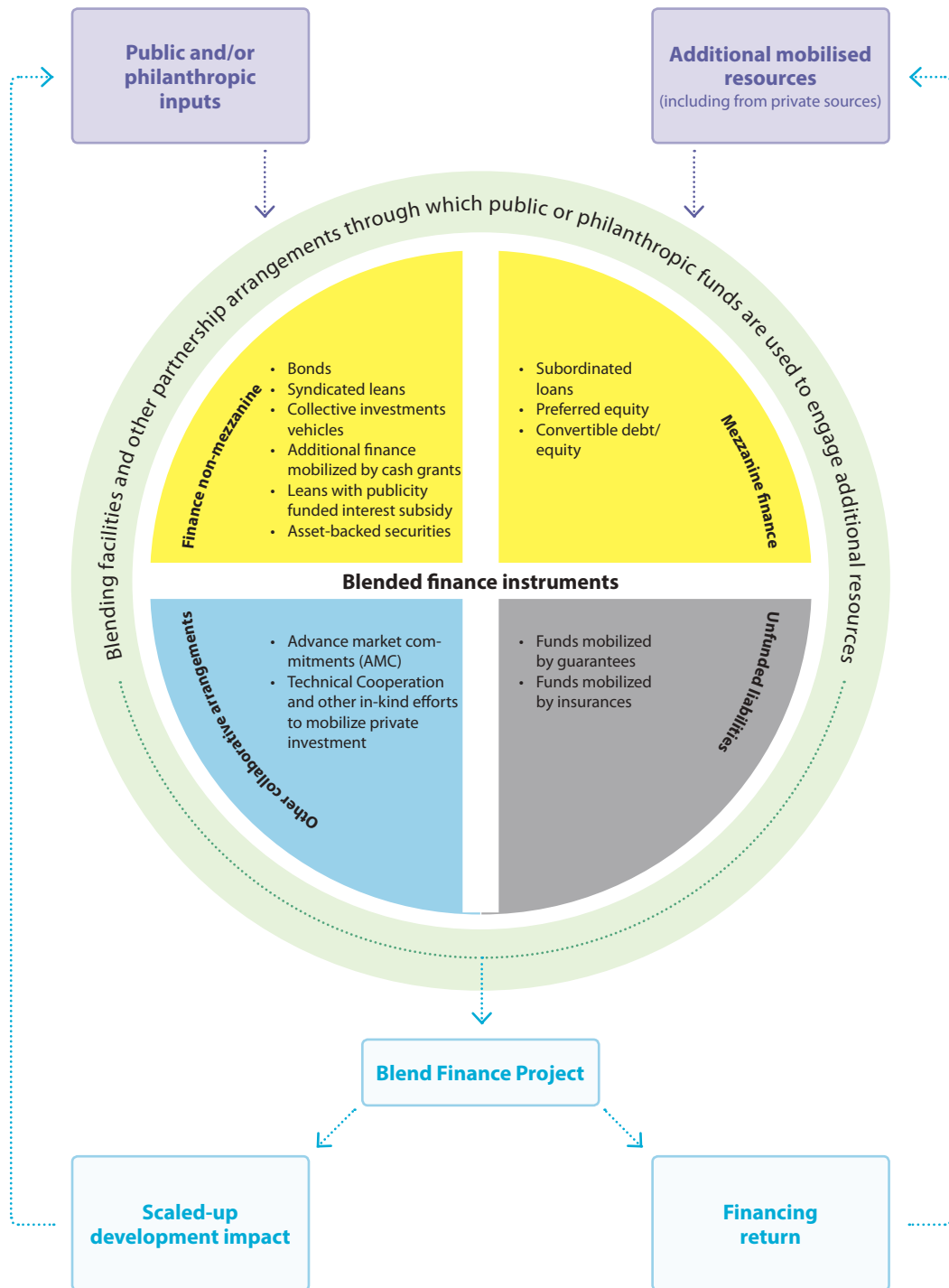
It is a market that is now maturing, and blended finance is becoming a recognized best practice to mobilize additional public and commercial capital for development projects. A considerable body of experience, evidence and expertise now exists. In the current context of transformation put forward by the 2030 Agenda, blended finance (when done well) represents an opportunity to mobilize considerable additional resources, especially for “big-ticket” items such as sustainable infrastructure investments.

Links to Further Resources:

- [Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders](http://www3.weforum.org/docs/WEF_Blended_Finance_A_Primer_Development_Finance_Philanthropic_Funders_report_2015.pdf)
www3.weforum.org/docs/WEF_Blended_Finance_A_Primer_Development_Finance_Philanthropic_Funders_report_2015.pdf
- [Blended Finance Tool-kit](http://www.weforum.org/reports/blended-finance-toolkit)
www.weforum.org/reports/blended-finance-toolkit
- [A How-To Guide for Blended Finance](http://www3.weforum.org/docs/WEF_Blended_Finance_How_To_Guide.pdf)
www3.weforum.org/docs/WEF_Blended_Finance_How_To_Guide.pdf



Blended Finance: How it Works



Source: UNDP, AFD and Development Initiatives



UNDP Experience with Blended Finance: a Green Mortgage Scheme for Rural Homes in Uzbekistan

This US\$ 6million GEF-funded UNDP supported project, approved in 2015, aims to promote the greening of Uzbekistan's rural housing programme. This programme will construct 75,000 standard (non-green) rural homes in the period 2016-2020, at an approximate cost of US\$ 5 billion. The project seeks to use limited public resources to shift this housing programme to a greener trajectory.

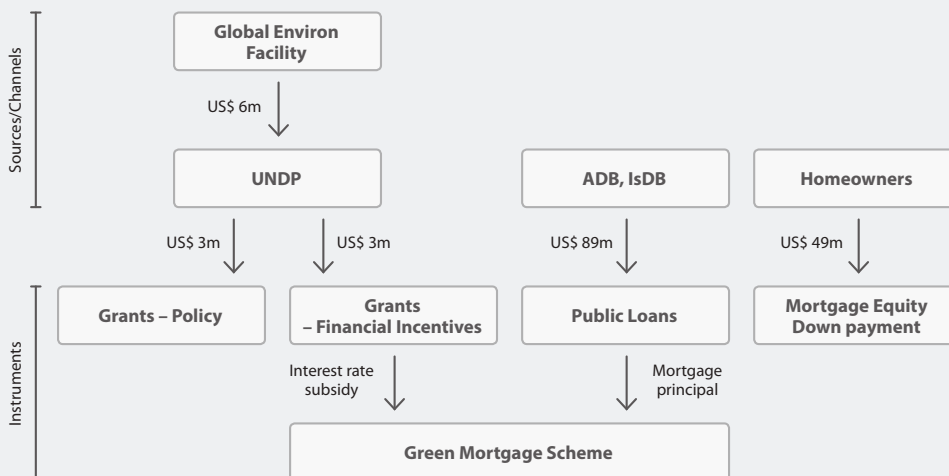
The project designs, combines and sequences multiple instruments and sources of financing.

The financial centrepiece of the project is a pilot green mortgage scheme, which will act to incentivize home-owners to opt for green homes (energy efficient, solar powered) via lower-cost green mortgages. The initial pilot is for 3,000 green mortgages. The scheme combines a US\$ 3 million UNDP grant-instrument (providing a financial incentive for each green mortgage secured), with public loans from the Asian Development Bank (ADB) and Islamic Development Bank (IsDB). These loans, which will be recycled as mortgages, are estimated to total US\$ 89 million for the pilot.

The pilot will also leverage domestic climate finance, supplied by the participating owners of green homes, who themselves are estimated to provide US\$ 49 million in equity down-payments for the pilot.

A range of sector-wide, policy measures, including support for green building codes and for the domestic building materials supply chain, will be funded by an additional US\$ 3 million UNDP grant instrument. These measures aim to create an enabled policy environment, laying the ground-work for a successful pilot, and the subsequent expansion and replication of the green mortgage scheme nationally, across the entire rural housing programme.

Combining and Sequencing Instruments



Source: UNDP-GEF project document

UNDP Experience with Blended Finance: Derisking Renewable Energy Investment in Tunisia

This US\$ 4 million GEF-funded UNDP supported project, which began implementation in 2016, is supporting Tunisia to achieve the 2030 investment targets in the Tunisia Solar Plan (TSP). The TSP is Tunisia's official long-term plan to harness renewable energy and energy efficiency to advance sustainable development. It is the major component, accounting for 75 percent of emission reductions, in Tunisia's recently submitted Intended Nationally Determined Contribution (INDC) to the UNFCCC.

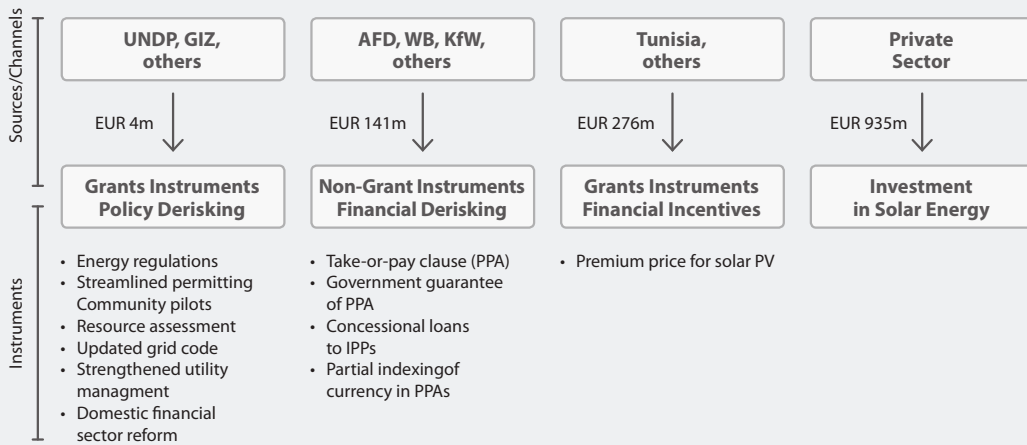
Based on modelling using UNDP's innovative 'Derisking' methodology, the project identifies the most cost-effective combination of public measures to address investment risks for private sector investment in renewable energy. Three categories of instruments are being designed, combined and sequenced:

- 'Policy derisking instruments', for example, power market regulations and streamlined permitting procedures;
- 'Financial derisking instruments', for example, loan guarantees and foreign exchange hedging;
- 'Direct financial incentives', for example, a premium price for renewable energy generators.

The modelling is demonstrating how carefully targeted combinations of public instruments can have significant benefits in bringing reliable, more affordable and cleaner power to Tunisia. Initial results have shown how derisking instruments estimated to cost EUR 145 million to 2030, complemented by financial incentives estimated at EUR 276 million, can catalyze EUR 935 million in private sector investment in solar energy. Such measures will create savings to Tunisia of EUR 359 million over the next 20 years, as compared to Tunisia's baseline energy costs.



Combining and Sequencing Instruments



Source: UNDP-GEF project document



UNDP Adam Rogers
Togo



2. Financing Sustainable Development with Green and Blue Bonds⁵³

“Green” finance is an area that has experienced a considerable boom over recent years. A plethora of funds, programmes and initiatives now exists in this area, such as the Global Environment Facility, the UN REDD Programme, the Adaptation Fund and most recently the Green Climate Fund.

One area in the green finance domain that has experienced a particularly rapid rise is that of so-called “green bonds”. “Green bonds” are a relatively new financial instrument that ties the proceeds of a bond issue to environmentally-friendly investments.

Issuers of bonds can be private companies, supranational institutions (such as multilateral banks) and public entities (municipal, state or federal). The Climate Bonds Initiative estimates that bonds explicitly labelled as “green” which earmark 100 percent of their proceeds to a specific environmental purpose or project amounted to US\$ 118 billion in 2016. A further US\$ 531.8 billion of bonds were issued whose proceeds were used to fund climate/environment solutions but which did not explicitly carry the “green” label.

Multilateral development banks and corporates have been the largest issuers of labelled green bonds to-date. In 2014 and 2015, the European Investment Bank issued US\$ 11.6 billion, the World Bank US\$ 8.5 billion and the German Development Bank (KfW) US\$ 4 billion. Other multilateral development banks have also issued labelled green bonds.

In the industrialized world, green bonds issued by municipalities have become a key part of the market. Energy, low-carbon buildings and transport-related projects are the most popular projects to fund with more than 38 percent allocated to the financing of renewable energy initiatives. Several large emerging economies such as Brazil, China, India, Mexico and South Africa have also built dynamic green bond markets at the domestic level over recent years.

The world’s largest issuer is currently the European Investment Bank. Its “Climate Awareness Bond” supports lending for energy projects in high-income countries, although it has also used this financial instrument to lend to a number of middle and low-income economies.

The World Bank is also a major player and reports that as at end-2015 it had carried out over 100 green bond transactions in 18 currencies, supporting about 70 climate adaptation and mitigation projects in the developing world with the proceeds. The vast

⁵³ Extracted and adapted from: UNDP and AFD, Financing the SDGs in the Least Developed Countries (LDCs): Diversifying the Financing Tool-box and Managing Vulnerability (2016): <http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/afd-undp-financing-sustainable-development-and-managing-vulnerab.html>



majority of these have supported IBRD-lending to energy and transportation projects in large middle-income countries.

Other multilateral development banks have also started to use this financing modality over recent years. The African Development Bank established its “Green Bond Program” in 2013 to finance or co-finance projects in the areas of renewable energy, energy efficiency, emissions reductions and waste management, amongst other areas. In 2015, the Asian Development Bank launched a programme in this area with a US\$ 500 million inaugural green bond issue that aims to channel more investor funds to Asian Development Bank projects that promote the transition to low-carbon and climate resilient growth. Large middle-income countries such as China, Indonesia and the Philippines have benefited so far with loans from the programme.

Green bond issuers have tapped into a broad spectrum of investors that include pension funds, insurance companies, asset managers, companies, foundations and religious organizations. The World Bank reports that as issuances have increased in size, the types of investors have also become increasingly diverse. Investors’ appetite for these types of securities can also be expected to increase in the future. Several major international banks have recently established dedicated funds to invest in socially and environmentally focused activities such as green bonds. The Climate Bonds initiative reports that most issuances are heavily oversubscribed as investors with over US\$ 45 trillion in assets increasingly make public commitments to climate and responsible investment.

“Blue” bonds are a variation on this theme with particular relevance to Small Island Developing States (SIDS) and countries with large coastal areas. Modelled on green bonds and pioneered by the Seychelles, blue bonds target socially and environmentally responsible investors, with the proceeds used to fund investments in sectors such as sustainable fisheries development. The Seychelles has recently made an initial sale of US\$ 10 million in 2017. If successful, the Seychelles hopes to expand the project further in the future and incorporate other Indian Ocean island states, such as Comoros, Madagascar and Mauritius.

International and national development banks have been the ones to kick-start and shape the green bond market. Public issuance has been essential to establish models, provide initial market liquidity and educate investors about this asset class. They have also been more easily able to absorb some additional transaction costs associated with these bonds because issuers must track, monitor and report on the use of the proceeds during the lifetime of the bond.

While labelled green bonds remain a small proportion of worldwide bond markets (estimated at over US\$ 100 trillion), the amounts are large compared to overall finance available for environmental protection and climate change adaptation and mitigation. If recent trends are anything to go by, the market can be expected to develop even further in the future. Fiji is now preparing its first green bond issuance on international capital markets.



Looking forward, socially and environmentally aware investments such as these offer promising ways to raise additional large-scale resources for urgent investments in areas such as renewable energy, energy efficiency, low-carbon transport and protection of the oceans. High-quality ‘bankable’ projects are needed that maximize social, environmental and financial returns. In many instances however the risk of poorly-designed or implemented projects remains high with implications for countries’ debt sustainability profiles. Weak institutional capacity may also hinder efforts to closely monitor and report on projects financed in part or in full by these securities. International development partners can in many cases help to develop a green investment project pipeline.

Links to Further Resources:

- [Climate Bonds Initiative](http://www.climatebonds.net/)
www.climatebonds.net/
- [Climate Bonds Standards and Certification](http://www.climatebonds.net/standards)
www.climatebonds.net/standards
- [UNDP Financing Solutions for Sustainable Development: Green Bonds](http://www.undp.org/content/sdfinance/en/home/solutions/green-bonds.html)
www.undp.org/content/sdfinance/en/home/solutions/green-bonds.html
- [World Bank Green Bonds](http://treasury.worldbank.org/cmd/htm/WorldBankGreenBonds.html)
treasury.worldbank.org/cmd/htm/WorldBankGreenBonds.html

Source: UNDP and AFD

3. Enhancing Access to Credit with Guarantees for Development⁵⁴

Guarantees – a type of “insurance policy” that protects national or sub-national governments, banks and investors from the risks of non-payment or loss of value in case of an investment – have been a mainstay of financial markets all over the world for many years. Guarantees for “development” are those extended with the promotion of the economic welfare and development of developing countries as the principal objective.

Guarantees promise indemnification up to a specified amount in the case of default or non-performance of an asset (e.g. a failure to meet loan repayments or to redeem bonds, or expropriation of an equity stake). There are many private providers of guarantees, but in many developing countries, and for certain types of risks, only public (national or multilateral) providers are available. This includes in particular political risks. For commercial risks (e.g. credit, regulatory/contractual) that investors are unwilling or unable to bear there is usually a broader range of suppliers. All guarantees help the borrower to obtain financing at better terms than would be possible without the guarantee.

Guarantees for development are a valuable instrument for mobilizing resources from the private sector – be they from private companies, banks, individuals, non-govern-

⁵⁴ Extracted and adapted from: UNDP and AFD, Financing the SDGs in the Least Developed Countries (LDCs): Diversifying the Financing Tool-box and Managing Vulnerability (2016): <http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/afd-undp-financing-sustainable-development-and-managing-vulnerab.html>



mental organizations (NGOs), investment funds or others. For a fraction of the potential cost of the risk exposure undertaken, considerable liquid resources can be deployed for investments to support economic development in developing countries. They can be used in a myriad of ways, such as: i) backstopping financing for large-scale, multiyear infrastructure projects; ii) lengthening the maturities of loans to small enterprises; iii) refinancing municipal utilities; iv) enabling local banks to enter new markets such as mortgage or microenterprise lending; or v) deepening capital markets by facilitating local-currency bond issues.

Guarantees are undergoing a rapid evolution which may provide important opportunities for many developing countries. New combinations of donor agencies and philanthropic investors have been emerging over the last decade. Philanthropic investors for instance have become new partners to the official sector. They often structure their investments with a “first loss” platform to achieve high social returns in exchange for assuming substantial downside financial risks. They are often willing to take the riskiest part of the capital structure, which is typically equity or quasi-equity. They use this base to attract others to less risky layers of a fund (and for which they will receive a more limited return). These investors use “waterfall” financing models where loan tranches are structured according to risks. Guarantees are thus associated with a wide range of financing vehicles – bonds, loans, equities, insurance – and are also designed to mobilize private sources from the entire spectrum of the economy.

According to OECD estimates, 40 percent of guarantees has targeted banking and financial services, backstopping lines of credit for small- and micro-enterprises, mortgage finance, rural credit co-operatives, small farmers associations and industrial refinancing, amongst other areas. This is followed by energy, infrastructure and industry.

Despite the attractiveness of guarantees for development, there are also several constraints - on both the supply and demand sides. On the supply side, most guarantee products are more complex instruments than loans and generally require more resources to structure and execute. This can increase costs. On the demand side, guarantees by themselves cannot overcome problems inherent to a poorly-designed project or an un-creditworthy borrower. In this context, guarantees are most effective when they are part of a broader effort to build the capacity of both banks and SMEs; on the one hand banks need to be able to better understand and assess risk and on the other hand, SMEs as borrowers need to better understand how to manage cash flows and assess financing needs.

Links to Further Resources:

- [UNDP Financing Solutions for Sustainable Development: Public guarantees](http://www.undp.org/content/sdfinance/en/home/solutions/public-guarantees.html)
<http://www.undp.org/content/sdfinance/en/home/solutions/public-guarantees.html>
- [OECD Guarantees for Development](http://www.oecd.org/dac/stats/guarantees-for-development.htm)
<http://www.oecd.org/dac/stats/guarantees-for-development.htm>

Source: UNDP and AFD



UN Photo Marco Dormino
Gao, Mali

4. Impact Investing

Overview

Impact investing has emerged as an important source of development finance in recent years. While the size of the sector is difficult to quantify, the Global Impact Investing Network (GIIN) approximates that the sector's assets under management (AUM) stood at US\$ 114 billion in 2016.⁵⁵

Roughly 42 percent of these assets are identified as invested in emerging market and developing economies (EMDEs).⁵⁶ Sub-Saharan Africa commands the largest share of global impact investing assets directed towards EMDEs at 10 percent, while the Middle East and North Africa accounts for the least at 2 percent.⁵⁷

What is Impact Investing?

Impact investments are investments made into companies, organizations and funds that aim to generate measurable social and environmental impact alongside a financial return.⁵⁸ While considered a distinct asset class, impact investment uses a range of traditional financial instruments including private equity, debt and fixed income securities. According to GIIN the most frequently used instruments are private equity followed by private debt.

⁵⁵ GIIN 2017 Annual Impact Investor Survey (May 2017)
https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf

⁵⁶ Estimated based on GIIN data. GIIN 2017 Annual Impact Investor Survey (May 2017).

⁵⁷ Ibid.

⁵⁸ GIIN definition.



Investors tend to concentrate in basic needs sectors such as housing, energy, health, agriculture and microfinance. In EMDEs an additional focus is on businesses that meet the needs of underserved or ‘bottom of the pyramid’ (BOP) customers that are typically overlooked by markets.⁵⁹

The emphasis is also on innovation which can provide new, market-based solutions to tough development challenges at scale. For instance, Kenya-based Bridge Academies International (BIA) is one example of an innovative business model that is tackling the dearth of high-quality affordable primary and pre-primary education in Africa and India. BIA developed an “academy-in-a-box” franchise solution to providing low-cost education that delivers scripted lessons through cheap mobile technology. This allows the enterprise to provide poor families living on an average of US\$ 1.60 a day the means to educate their children for around US\$ 6.50 a month.⁶⁰ The venture has grown from two schools and 300 pupils in 2009 to 520 schools and over 100,000 pupils today.⁶¹

Investor Profiles

Because, by definition, impact enterprises need to demonstrate financial viability and not just the intent to create impact, it is helpful to categorize impact investors according to the business stages they primarily fund.

Early-Stage

At one end of the spectrum, early-stage or pioneer funds help incipient ventures, typically those with revenues of less than US\$ 500,000 but also those with no revenues, become investment-ready. In addition to providing capital, these investors also provide business development services to reduce the risk inherent in these unproven startups. Acumen Fund – one of the earliest dedicated pioneer impact funds – leverages charitable donations to provide ‘patient capital’ to businesses serving BOP customers.

Social impact incubators and accelerators are also important players in early stage funding. Impact Hub for example is a global network of incubators that provides training programmes to vetted social entrepreneurs to help develop their business ideas to the growth stage. Impact Hub Geneva and UNDP initiated Accelerate2030 in 2016 to deliver a 9-month programme for social ventures that can go on to contribute to the SDGs.⁶² Entrepreneurs are also sometimes awarded seed capital, and networking opportunities with potential investors that can fund their companies beyond the initial stages.

For instance, UNDP’s Kolba Innovations Lab in Armenia provides between US\$ 3,000 and US\$ 10,000 to innovators to develop prototypes of their ideas.⁶³ Successful ideas

⁵⁹ Defined as consumers living on less than \$2.50 a day.

⁶⁰ UNDP Working Paper, Impact Investing in Africa (November 2014); p.25

⁶¹ For further information, see: <http://www.bridgeinternationalacademies.com/approach/reach/>

⁶² For further information, see: <http://www.accelerate2030.net>

⁶³ For further information, see: <https://medium.com/innovation-in-the-age-of-the-sustainable-developme/armenia-a-lab-to-experiment-in-9a25e2bfa662>



can sometimes go on to become UNDP or government-backed projects. Since beginning in 2011, Kolba has received 580 ideas, and incubated 40 start-ups.⁶⁴

Growth-stage to Mature Operations

Social enterprises further up the capital curve can access larger-scale finance from private equity funds, development finance institutions (DFIs), philanthropic foundations and institutional investors depending on their capital requirements and sector focus.

Private equity impact funds tend to focus on, low-risk, medium-return SMEs with proven business models. Available data for Africa shows that investment allocations range between US\$ 5 - US\$ 80 million⁶⁵ and expected returns between 15 – 20 percent depending on risk perceptions.⁶⁶ There are many funds to choose from in the space including Accion, Developing World Markets, LeapFrog Investments and Vital Capital Fund.

Funding from DFIs and institutional investors are more suited to mature operations or large-scale projects in infrastructure, renewable energy, agriculture, real estate and financial services. Many DFIs such as the International Finance Corporation and the UK's Commonwealth Development Corporation have been making impact investments in EMDEs for over half a century, while others such as the Netherland's Dutch Good Growth Fund are relatively new structures set up specifically in response to growing demand for public entities to catalyze private impact investments into developing countries. Capital available through DFIs for individual deals range from US\$ 5 - US\$ 50 million.⁶⁷

Traditional Institutional Investors

Institutional investors include traditional asset managers such as JP Morgan, pension funds such as South Africa's Public Investment Corporation, and even investment banks that are capitalizing on their vast experience of underwriting deals in emerging markets to set up their own dedicated impact funds.

Last year, Credit Suisse Private Banking Asia Pacific and Singapore's UOB Venture Management launched a new impact investing venture capital fund for ultra-high-net-worth individuals to support SMEs in Asia. Its first investment is in a Chinese venture that produces soy-based nutrition packets for babies in rural areas that suffer disproportionately from stunted growth syndrome. The investment will help the company expand its reach to over 600,000 additional babies.⁶⁸

Although institutional investors are relatively new entrants into impact investing, they could hold the key to growing the sector to maturity in the future. These traditional in-

⁶⁴ For further information, see: http://www.am.undp.org/content/armenia/en/home/operations/projects/democratic_governance/kolba-innovations-lab-.html

⁶⁵ UNDP Working Paper, Impact Investing in Africa (November 2014)

⁶⁶ Ibid.

⁶⁷ Ibid; p.43.

⁶⁸ For further information, see: <http://www.barrons.com/articles/asias-banks-take-stand-on-impact-investing-1466475400>

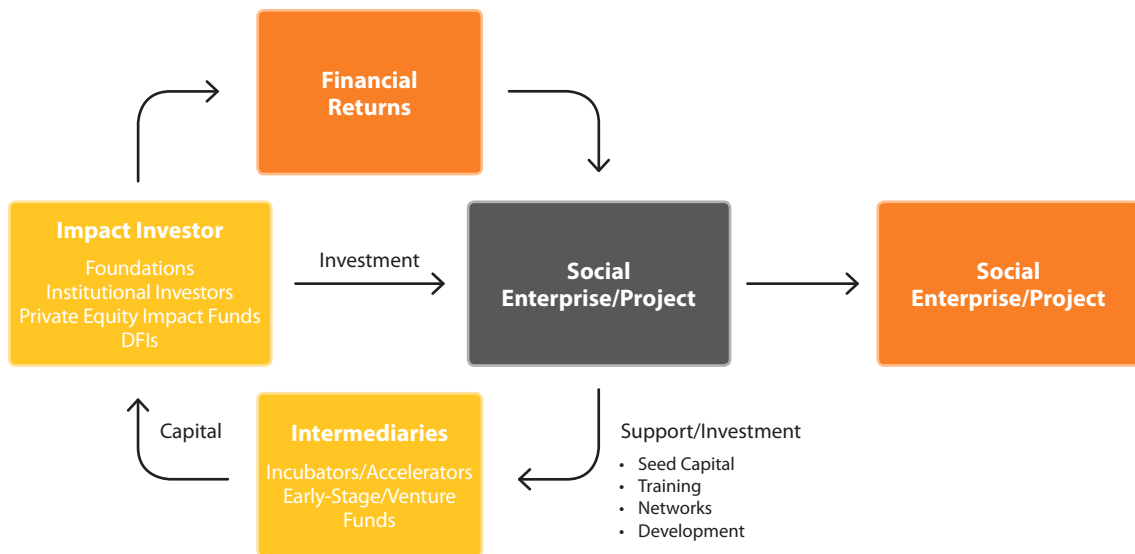


vestors oversee vast sums of private wealth, such as BlackRock (which set up BlackRock Impact in 2015) with US\$ 5.7 trillion under management.⁶⁹ As such, they can facilitate deal sizes of up to US\$ 200 million per transaction in EMDEs.⁷⁰ However, their low risk tolerance could put them out of the reach of a vast majority of impact ventures in low-income countries.

Despite these distinctions, the reality of impact investing in developing countries is that all investors support enterprises along the entire financing value chain, particularly in these early stages when bankable private sector impact projects are still in short supply. This can be through foundations like the Rockefeller Foundation and the Bill and Melinda Gates Foundation investing in funds that make grants and concessionary finance to early-stage ventures, or DFIs and governments partnering with institutional investors to ‘enable’ deals in high risk projects by providing co-financing and guarantees.

Figure 1 below is a simple model of the impact investment process in developing countries.

Figure 1: The Impact Investment Process



Source: Omamuli (2017)

69 For further information, see: <https://www.blackrock.com/au/individual/about-blackrock>

70 UNDP Working Paper, Impact Investing in Africa (November 2014)



Future Prospects

Looking ahead, impact investing still has a long way to go before it can solve the trillions-of-dollars gap in SDG financing needs. Moreover, its expansion has not kept pace with earlier optimistic forecasts.⁷¹ However, at just 0.2 percent of global wealth,⁷² there is considerable room for further growth. Lack of wider familiarity with the style of investing and limited supply of capital continue to constrain the sector.

Potential Risks

Impact investments are subject to the same investment risks as traditional investments in developing countries such as political, transfer and economic risks, and the imperative to 'do good' will not override these considerations. Hence, flows of impact investments can be just as unstable as other private flows, fluctuating according to business cycles rather than development needs.

The entrance of traditional institutional investors has also raised concerns over 'greenwashing'⁷³ and 'impact dilution'⁷⁴ wherein financial considerations may take precedence over social and environmental considerations. This could lead to unscrupulous behaviour such as mislabelling to attract the growing number of investors that are demanding more impact products for their portfolios.

Further Information

Research

- [GIIN: What You Need to Know About Impact Investing](https://thegiin.org/impact-investing/need-to-know/#s7)
https://thegiin.org/impact-investing/need-to-know/#s7
- [Impact Investing in Africa \(UNDP\)](http://www.undp.org/content/dam/undp/library/corporate/Partnerships/Private%20Sector/Impact%20Investment%20in%20Africa/Impact%20Investment%20in%20Africa_Trends,%20Constraints%20and%20Opportunities.pdf)
http://www.undp.org/content/dam/undp/library/corporate/Partnerships/Private%20Sector/Impact%20Investment%20in%20Africa/Impact%20Investment%20in%20Africa_Trends,%20Constraints%20and%20Opportunities.pdf
- [Impact Investment: The Invisible Heart of Markets](http://www.socialimpactinvestment.org/reports/Impact%20Investment%20Report%20FINAL%5b3%5d.pdf)
http://www.socialimpactinvestment.org/reports/Impact%20Investment%20Report%20FINAL%5b3%5d.pdf
- [Measuring Impact – How Business Accelerates the Sustainable Development Goals](https://www.businesscalltoaction.org/sites/default/files/resources/MeasuringImpact_web_0.pdf)
https://www.businesscalltoaction.org/sites/default/files/resources/MeasuringImpact_web_0.pdf

⁷¹ A 2009 report by the Monitor Institute predicted impact investing assets could reach \$500 billion by 2020, which is unlikely at current growth rates. For further information, see: http://monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing.pdf

⁷² For further information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/impact-investment.html>

⁷³ For further information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/impact-investment.html>

⁷⁴ GIIN 2017 Annual Impact Investor Survey (May 2017)
https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf



Links to UNDP Initiatives

- [UNDP Social Impact Fund](http://undp.socialimpact.fund)
http://undp.socialimpact.fund
- [AltFinLab](http://altfinlab.org/)
http://altfinlab.org/
- [Global Islamic Finance and Impact Investing Platform](http://www.iicpsd.undp.org/content/dam/istanbul/docs/IslamicFinance_BroWEB.pdf)
http://www.iicpsd.undp.org/content/dam/istanbul/docs/IslamicFinance_BroWEB.pdf
- [Accelerate2030](http://www.accelerate2030.net)
http://www.accelerate2030.net
- [Financing Solutions for Sustainable Development: Impact Investing \(UNDP\)](http://www.undp.org/content/sdfinance/en/home/solutions/impact-investment.html)
http://www.undp.org/content/sdfinance/en/home/solutions/impact-investment.html

5. Enterprise Challenge Funds

Overview

Enterprise challenge funds are used by governments, development agencies and philanthropic foundations to channel matching funds to enterprises in developing countries to spur innovative, private sector solutions to sustainable development. They award grants or concessional finance to commercially viable businesses or projects to address a defined developmental problem (challenge) on a competitive basis, and are used in a variety of sectors including agriculture, health, financial services for the poor and education.

Initially championed by the UK's Department for International Development (DFID), enterprise challenge funds are now used by many other donors including the Swedish International Development Cooperation Agency (SIDA), the International Labour Organisation (ILO) and the Bill and Melinda Gates Foundation. Collaborations between several of these players are also common such as with the Africa Enterprise Challenge Fund (AECF) and the Business Sector Advocacy Challenge Fund.

Challenge funds differ greatly in size, from the US\$400 million global Girl's Education Fund (GEC)⁷⁵ to the single-country US\$ 3 million Vietnam Business Challenge Fund⁷⁶

Mode of Operation

Enterprise challenge funds are set up for a limited duration, usually no less than two years, and run by contracted fund managers, typically management consulting or professional services firms, such as PwC International or KPMG on behalf of donor

⁷⁵ Anne-Marie O'Riordan, James Copestake, Juliette Seibold & David Smith; Triple Line Consulting Ltd. & University of Bath working paper; December 2013; Challenge Funds in International Development; p.19.

⁷⁶ Claudia Pomper; ODI working paper; October 2013; Understanding Challenge Funds; p.6.



agencies.⁷⁷ The fund managers oversee the screening and selection of applicants for the fund, perform due diligence on selected companies, disburse funds to grantees, perform financial and risk management, monitor the investment portfolio, and market and advertise the fund's activities.

Competition for challenge funding begins with calls for targeted proposals from the private sector against prescribed eligibility criteria. At a minimum, prospecting companies must be able to demonstrate: a track record of at least two years of business operations, implementation of corporate social responsibility policies, audited accounts, and proof of legal and ethical operations.

Eligible proposals are then vetted by an independent investment panel made up of relevant experts from business and banking, to decide which ones will be invited to submit detailed business plans. At this stage, applicants are scrutinized to ensure they satisfy the core requirements for challenge funding i.e. innovation that delivers benefits for the poor, lack of access to alternative finance, commercial sustainability after funding ends and potential for replicability through demonstration and imitation effects.

Successful firms receive a one-off, limited duration grant, usually covering up to 50 percent of project costs with the remainder to be matched by the private sector.⁷⁸ Disbursements of funds are subject to the achievement of performance milestones stipulated in the contractual agreement between the fund and winning bidders.

Acceptance rates at the proposal stage can be very low, around 2-4 percent, but much higher at the final selection stage at over 50 percent.⁷⁹ An illustration of the process can be seen from the UNDP-funded Malawi Innovation Challenge Fund (MICF) first round, which attracted proposals from 202 companies, only 29 of which were invited to develop business plans, and awarded grants to 22 winning bidders.⁸⁰

Enterprise Challenge Funds in Action

Since DFID pioneered the use of enterprise challenge funds in developing countries with its Business Sector Challenge Fund in 1997, around 26 (live and concluded) funds have been set up by various agencies and governments across the world.⁸¹ Total investment in challenge funds is estimated at over US\$ 1 billion, while the average grant

⁷⁷ Anne-Marie O'Riordan, James Copestake, Juliette Seibold & David Smith; Triple Line Consulting Ltd. & University of Bath working paper; December 2013; Challenge Funds in International Development; p.23.

⁷⁸ For further information, see:
<http://www.undp.org/content/sdfinance/en/home/solutions/enterprise-challenge-fund.html>

⁷⁹ For further information, see:
<http://www.undp.org/content/sdfinance/en/home/solutions/enterprise-challenge-fund.html>

⁸⁰ Ibid.

⁸¹ As of 2013: Anne-Marie O'Riordan, James Copestake, Juliette Seibold & David Smith; Triple Line Consulting Ltd. & University of Bath working paper; December 2013; Challenge Funds in International Development; p.23. This figure includes both mixed social and enterprise challenge funds.



falls within the range of US\$ 100,000 to US\$ 1.5 million.⁸²

Most funds (50 percent) have a regional focus such as the AECF and the Latin America Impact Economy Innovations Fund, which is backed by philanthropic foundations including Fundación Avina.⁸³ Omidyar Network and the Rockefeller Foundation. About 30 percent⁸⁴ focus on a single country including MICF, while the rest (23 percent) are global such as SIDA's Innovations Against Poverty.⁸⁵ Individual funds can focus on multiple sectors, sometimes with multiple funding windows per sector.

For instance, AECF focuses on renewable energy and climate change adaptation technologies, agribusiness, and financial services that support both sectors. It also operates eight thematic and country specific windows (South Sudan, Tanzania and Zimbabwe). All windows accept global applications to optimize the number of quality applications while ensuring local solutions for the greatest impact. MICF, also operates five funding windows around its three core sectors, agriculture, manufacturing and logistics.

Evidence of Impact

Despite the significant funding provided and the number of facilities in operation, there is insufficient evidence to demonstrate whether enterprise challenge funds consistently deliver long-term development impacts. What evidence exists tends to be based on project narratives, which impede generalizations about the overall effectiveness of this funding modality. Nevertheless, development results from specific projects can still make for compelling evidence.

Figure 1 below illustrates the process by which an enterprise challenge fund grant can bring about systemic change.⁸⁶

⁸² For further information, see:

<http://www.undp.org/content/sdfinance/en/home/solutions/enterprise-challenge-fund.html>

⁸³ Anne-Marie O'Riordan, James Copestake, Juliette Seibold & David Smith; Triple Line Consulting Ltd. & University of Bath working paper; December 2013; Challenge Funds in International Development; p.23.

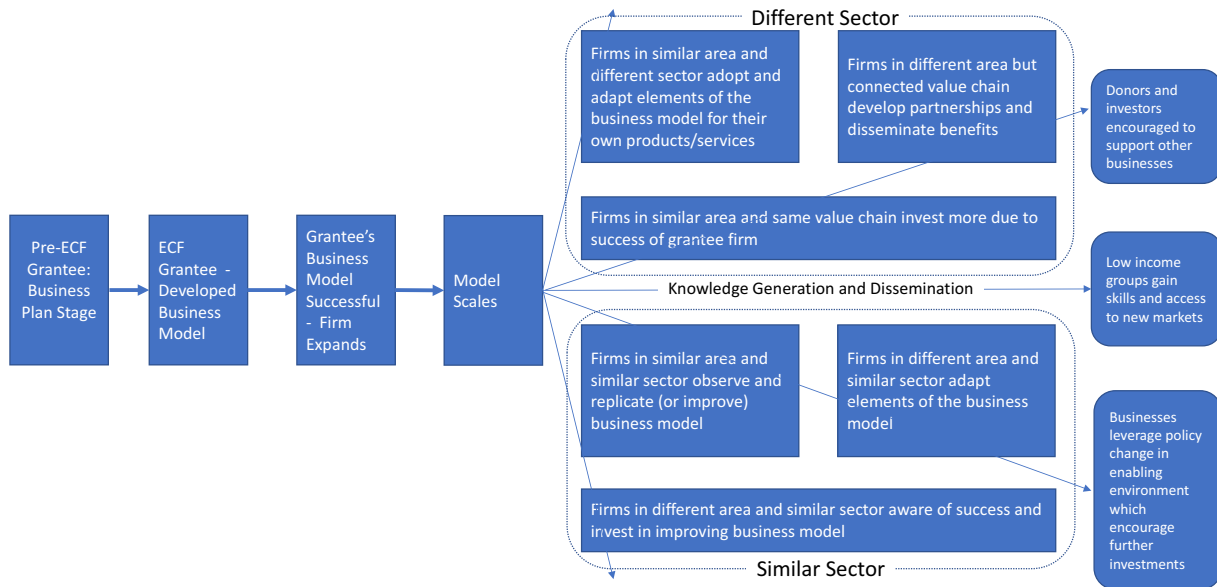
⁸⁴ Ibid.

⁸⁵ Ibid.

⁸⁶ Adapted from Adam Brain, Nilima Gulrajani & Jonathan Mitchell; EPS PEAKS; April 2014; Meeting the Challenge: How Can Enterprise Challenge Funds be Made to Work Better; p.12.



Figure 1: How an Enterprise Challenge Fund Grant can Stimulate Systemic Change



Limitations

Frequently cited limitations of enterprise challenge funds include susceptibility to adverse selection whereby funds may attract high-risk applicants that are unable to secure funding from elsewhere. Enterprise challenge funds are also expensive to administer relative to the size of financing on offer. Although costs are not made public, some private estimates have placed them between 12-24 percent of a fund's budget, but they can be higher.⁸⁷ In the case of SIDA's Innovations Against Poverty Fund, PwC received 50 percent⁸⁸ of the € 2.6 million budget – a potentially significant diversion of scarce donor resources.⁸⁹ Finally, funds risk becoming subsidy schemes that benefit only a few enterprises and (fund managers) if they fail to deliver anticipated developmental impacts.

⁸⁷ Claudia Pomper; ODI working paper; October 2013; Understanding Challenge Funds; p.15.

⁸⁸ Ibid.

⁸⁹ For further information, see: <http://socialinnovation.se/innovations-against-poverty/>



Further Information

Guidance

- [Understanding Challenge Funds \(ODI\)](https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9086.pdf)
<https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9086.pdf>
- [Guidelines: Challenge Funds \(SIDA\)](http://www.sida.se/contentassets/3aa2456211934e8dac038ea55fcdcccd/guidelines---challenge-funds_3466.pdf)
http://www.sida.se/contentassets/3aa2456211934e8dac038ea55fcdcccd/guidelines---challenge-funds_3466.pdf
- [Measuring Results in Challenge Funds: Practical Guidelines for Implementing the DCED Standard](https://www.enterprise-development.org/measuring-results-the-dced-standard/implementing-the-dced-standard/#Sector_Specific_Guidelines)
https://www.enterprise-development.org/measuring-results-the-dced-standard/implementing-the-dced-standard/#Sector_Specific_Guidelines
- [Meeting the Challenges: How Enterprise Challenge Funds Can be Made to Work Better](http://www.geg.ox.ac.uk/sites/geg/files/How%20can%20enterprise%20challenge%20funds%20be%20made%20to%20work%20better.pdf)
<http://www.geg.ox.ac.uk/sites/geg/files/How%20can%20enterprise%20challenge%20funds%20be%20made%20to%20work%20better.pdf>
- [Financing Solutions for Sustainable Development: Enterprise Challenge Funds \(UNDP\)](http://www.undp.org/content/sdfinance/en/home/solutions/enterprise-challenge-fund.html)
<http://www.undp.org/content/sdfinance/en/home/solutions/enterprise-challenge-fund.html>

Challenge Fund Websites

- [Africa Enterprise Challenge Fund](https://www.aecfafrica.org/)
<https://www.aecfafrica.org/>
- [Malawi Innovation Challenge Fund](http://www.micf.mw/)
<http://www.micf.mw/>
- [Compete Caribbean](http://competecaribbean.org/program/)
<http://competecaribbean.org/program/>
- [Enterprise Challenge Fund for the Pacific and South-East Asia](http://www.enterprisechallengefund.org/)
<http://www.enterprisechallengefund.org/>
- [Innovations Against Poverty](http://www.snv.org/project/innovations-against-poverty-iap)
<http://www.snv.org/project/innovations-against-poverty-iap>



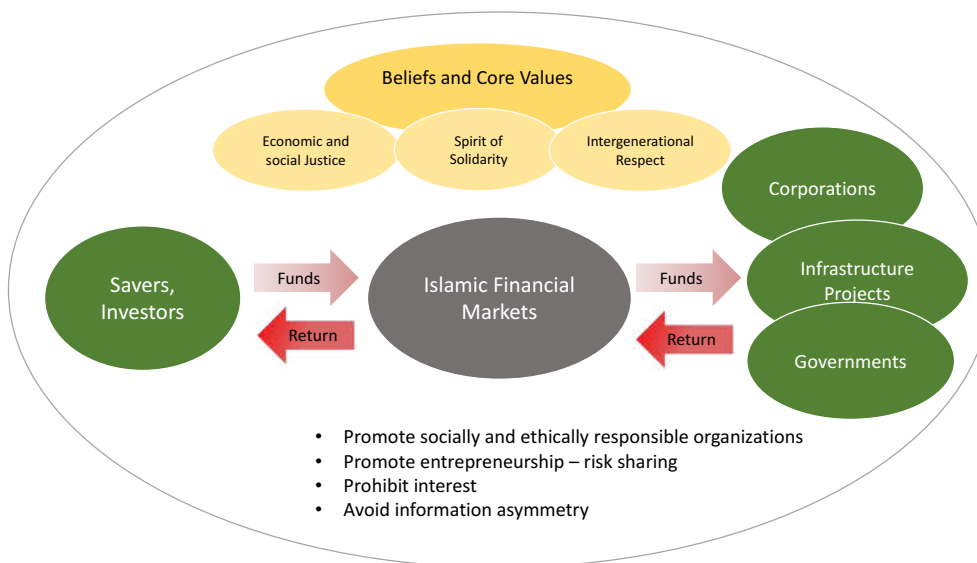
6. Islamic Finance

Overview

The potential for Islamic finance to contribute towards financing the SDGs is drawing increasing interest from international development organizations. The sector has grown rapidly over the last decade, from US\$ 200 billion in 2003 to US\$ 2 trillion in 2015⁹⁰ and its assets are expected to surpass US\$ 3 trillion by 2020.⁹¹ Moreover, the core principles of Islamic finance align well with those of the 2030 Agenda for Sustainable Development, which seeks to promote inclusiveness, equitable and participatory growth, social and distributive justice, open and accountable institutions and sustainability.

Islamic finance differs fundamentally from other financial systems because it is governed by sharia (Islamic law), which prohibits usurious or interest-bearing transactions – the mainstay of conventional finance. Instead, sharia-compliant transactions must, among other things, be asset-backed (i.e. linked to real economic activity), ethical, participatory and subject to good governance as summarized in the figure below.⁹²

Figure 1: Values-Driven Structure of Islamic Capital Markets



⁹⁰ Z.Noor, F.Pickup; BAZNAS, UNDP; The Role of Zakat in Supporting the Sustainable Development Goals; p.5.

⁹¹ IICPSD, IRTI & UNDP; March 2017; I for Impact: Blending Islamic Finance and Impact Investing for the Sustainable Development Goals; p.45.

⁹² World Bank and Islamic Development Bank Group; 2016; Global Report on Islamic Finance: Islamic Finance: A Catalyst for Shared Prosperity; Washington, DC: World Bank; doi:10.1596/978-1-4648-0926-2; License: Creative Commons Attribution CC BY 3.0 IGO; p.76.



The industry is gaining prominence in many developing countries, particularly in regions with large Muslim populations like sub-Saharan Africa where Islamic finance is now offered in 21 countries.⁹³ Potential also exists for further expansion into Muslim-majority Eurasian countries like Azerbaijan, Kazakhstan and Uzbekistan, and Latin American and Caribbean markets after Suriname and Guyana launched Islamic financial activities over the last two years.

The Islamic Development Bank (IDB) is the leading player in the sector, offering sharia-compliant financing with a direct mandate to advance economic development and social progress within its 57 member countries. Other international organizations including the United Nations, World Bank Group and Asian Development Bank are also becoming increasingly involved in Islamic Finance. Among private investors, Sovereign Wealth Funds (SWFs), Pension Funds and High-Net-Worth-Individuals (HNWIs) are key financiers for the sector.

Modes of Financing

Islamic financial instruments are based on three broad contractual structures.

Transactional contracts are debt-like instruments, which share similarities with conventional hire-purchase agreements, except that the financier takes a mark-up or 'profit' over the cost of the asset instead of interest. Murabahah is the most commonly used transactional contract and can be applied to microfinance as well as funding social and infrastructure projects.

Equity contracts are profit/loss sharing instruments typically used in joint ventures or project finance. Examples of equity contracts include mudarabah, which is similar to a silent partnership between a financier and an entrepreneur and musharakah, where investors partner and pool resources to fund a venture and share in its profits (or losses) according to each partner's capital contribution.

Support contracts are fee or commission based arrangements such as kafalah whereby an investor offers to guarantee a financial obligation on behalf of a client, and muzara'ah, which is a sharecropping arrangement that can be used to support sustainable agriculture.⁹⁴

Applications in SDG Financing

In the last few years, many Islamic financiers have joined global efforts to finance the SDGs through sharia-compliant versions of development financing tools such as green and social impact bonds, Islamic crowdfunding impact investing and Islamic social welfare assistance (zakat).

⁹³ EIU; November 2015; Mapping Africa's Islamic Economy; p.3.

⁹⁴ For detailed information on Islamic finance contracts see: IICPSD, IRTI & UNDP; March 2017; I for Impact: Blending Islamic Finance and Impact Investing for the Sustainable Development Goals; pp.42-45.



Green and Social Impact Bonds

Islamic bonds or sukuk contracts are increasingly being used by governments and international development agencies to raise large-scale capital for socially responsible and clean energy projects. The International Finance Facility for Immunisation (IFFm) issued its debut three-year US\$ 500 million sukuk murabahah in 2014 to fund vaccination development for children through the Global Alliance for Vaccination and Immunisation. Most of the sukuk's bidders (85%)⁹⁵ were new investors from the Middle-East and Asia, particularly Islamic banks (74 percent)⁹⁶ underscoring the strong demand for sharia-compatible SRI products among Muslim financiers. IFFm followed up with another successful US\$ 200 million sukuk in 2015.⁹⁷

At the country level, Malaysia's Khazanah Nasional Berhad – the national SWF – launched a one-billion-ringgit Sukuk Ihsan Programme in 2015 for the education sector, of which RM200 million has been issued to date.⁹⁸ The sukuk's unique contract allows for a 3.18 percent reduction in the principal to be repaid, and a lower profit rate if certain performance targets are met. Investors can also effectively convert their investments to donations at any time over the life of the sukuk.⁹⁹

Malaysia is positioning itself not only as a leading Islamic finance marketplace, but also as a global centre for sustainable finance, and has partnered with the World Bank to launch the world's first green sukuk in 2017, as well as to develop innovative Islamic financial instruments to address global infrastructure development needs.¹⁰⁰ Other Islamic finance hubs such as the United Arab Emirates and Saudi Arabia are also incorporating provisions for green and SRI sukuk in their regulatory frameworks to meet anticipated demand for environmentally sustainable infrastructure such as clean energy, mass transit and water conservation systems.

⁹⁵ <https://www.sc.com/global/av/IFFm-Press-Release-EN.pdf>

⁹⁶ World Bank and Islamic Development Bank Group; 2016; Global Report on Islamic Finance: Islamic Finance: A Catalyst for Shared Prosperity; Washington, DC: World Bank; doi:10.1596/978-1-4648-0926-2; License: Creative Commons Attribution CC BY 3.0 IGO; p.95.

⁹⁷ Malaysia World's Islamic Finance Marketplace; January 2016; SRI and Green Sukuk: Challenges and Prospects; p.2.

⁹⁸ For more information, see: <http://www.khazanah.com.my/Media-Downloads/News-Press-Releases/2017/Khazanah-raises-RM100-million-from-second-tranche>

⁹⁹ For more information, see: <http://www.khazanah.com.my/About-Khazanah/Our-Case-Studies/Khazanah-360/Sukuk-Ihsan-Sustainable-and-Responsible-Investment>

¹⁰⁰ For more information, see: https://www.sc.com.my/post_archive/malysias-first-green-sukuk-under-scs-sustainable-responsible-investment-sukuk-framework/



Islamic Crowdfunding

At the lower end of the finance market, small- and medium-sized enterprises (SMEs) are benefiting from new peer-to-peer crowdfunding modalities, which have emerged to increase access to finance for the sector. Jordanian-based Liwwa is an online platform that allows investors across the middle-east and north Africa to finance SMEs using lease-to-own murabahah contracts. Liwwa purchases capital goods on behalf of SMEs with proceeds from pooled investments on its platform, and distributes profits from their resale to investors for a fee. Since its inception in 2013, the platform has underwritten 196 loans worth over US\$ 6 million.¹⁰¹

Impact Investing

Despite the similarities in the ideological underpinnings of Islamic finance and impact investing, only a small number of the Global Impact Investing Network's members provide sharia-compliant products. Recognizing Islamic financiers demonstrated strong interest in development impact instruments, the IDB and UNDP created the Global Islamic Finance and Impact Investing Platform (GIFIIP) in 2017 to help connect more impact investors and enterprises with the sector. GIFIIP expressly aims to position Islamic finance and impact investing as a leading enabler of SDG implementation through private sector engagement.¹⁰² The platform will address the lack of awareness, capacity, advocacy and deal-sourcing services within both sectors, and is targeting five key outcomes including increasing access to impact enterprises that are unable to use conventional finance because of religious beliefs.¹⁰³

Zakat

As one of the five pillars of Islam, zakat is an ancient institution, but its potential is still vastly underdeveloped. Zakat is a mandatory obligation for all eligible Muslims to give at least 2.5 percent of their income to help the poor and needy. In practice, only a handful of Muslim-majority countries (Libya, Malaysia, Pakistan, Saudi Arabia, Sudan and Yemen), make paying zakat compulsory. In most other countries zakat is given informally, making it difficult to estimate its total value. Globally, zakat could mobilize between US\$ 200 billion and US\$ 1 trillion per year.¹⁰⁴ To channel this potential towards financing the SDGs, UNDP is working with institutions in Indonesia and other countries to strengthen their ability to collect and distribute zakat, and to help them achieve greater development impact.

¹⁰¹ For more information, see: <https://www.liwwa.com>

¹⁰² IICPSD, IRTI & UNDP; March 2017; I for Impact: Blending Islamic Finance and Impact Investing for the Sustainable Development Goals; p.72.

¹⁰³ Ibid; chapter 6.

¹⁰⁴ Ibid; p.5.



Drawbacks

A major drawback of Islamic finance is the divergence between its aspirations of fostering a participatory and equitable financial system, and the reality of the industry's current practices. The industry's assets are highly concentrated among HNWI and within a handful of relatively affluent 'QISMUT' countries (Qatar, Indonesia, Saudi Arabia, Malaysia, United Arab Emirates and Turkey) which account for 80 percent of the market. In addition, less than 8 percent of Islamic financing is provided on the risk/reward sharing basis that embodies the core principles of the sector, instead most transactions are based on the debt-like instruments prevalent in conventional finance.¹⁰⁵ This impedes the development of sectors such as SMEs, which are still largely underserved by formal Islamic financial services. Only 16 percent of banks surveyed by the IFC in 2014 provided product offerings for the sector compared with 47 percent in conventional banks.¹⁰⁶

Other promising instruments like sukuk still suffer from liquidity constraints reflecting limited issuance and a preference among Islamic financiers to hold the instrument to maturity, limiting the development of a deep secondary sukuk market. However, it is important to remember that Islamic finance is still a young industry and many of these obstacles will likely be resolved as it matures.

Further Information

- [I for Impact: Blending Islamic Finance and Impact Investing for the Global Goals](http://www.iicpsd.undp.org/content/istanbul/en/home/library/reports/l-for-Impact-Blending-Islamic-Finance-Impact-Investing.html)
http://www.iicpsd.undp.org/content/istanbul/en/home/library/reports/l-for-Impact-Blending-Islamic-Finance-Impact-Investing.html
- [Global Report on Islamic Finance](https://openknowledge.worldbank.org/handle/10986/25738)
https://openknowledge.worldbank.org/handle/10986/25738
- [World Islamic Banking Competitiveness Report](http://www.ey.com/Publication/vwLUAssets/ey-world-islamic-banking-competitiveness-report-2016/$FILE/ey-world-islamic-banking-competitiveness-report-2016.pdf)
http://www.ey.com/Publication/vwLUAssets/ey-world-islamic-banking-competitiveness-report-2016/\$FILE/ey-world-islamic-banking-competitiveness-report-2016.pdf
- [Islamic Development Bank](https://www.isdb-pilot.org)
https://www.isdb-pilot.org
- [Liwwa](https://www.liwwa.com/)
https://www.liwwa.com/
- [Islamic Corporation for the Development of the Private Sector](https://www.icd-ps.org)
https://www.icd-ps.org

¹⁰⁵ World Bank and Islamic Development Bank Group; 2016; Global Report on Islamic Finance: Islamic Finance: A Catalyst for Shared Prosperity; Washington, DC: World Bank; doi:10.1596/978-1-4648-0926-2; License: Creative Commons Attribution CC BY 3.0 IGO; p.69.

¹⁰⁶ Ibid; p.126.



7. Social and Development Impact Bonds

Overview

Social impact bonds (SIBs) and development impact bonds (DIBs) are types of payment-for-results schemes based on a public-private partnership arrangement between governments (or donors in the case of DIBs), private and nonprofit sectors to deliver social projects to disadvantaged populations. They are not bonds in the traditional sense which offer a fixed rate of return and repayment of principal on maturity. Instead, impact bonds are 'redeemed' by an outcome funder only if specified social outcomes are improved.

Impact bonds are a relatively new financial innovation. The first SIB was issued by Social Finance in 2010, to reduce recidivism among short-sentenced inmates released from Peterborough prison in the UK. The success of the scheme sparked wider global interest in SIBs, which have been adopted by 18 countries to date to fund interventions on a range of social issues including foster care, unemployment, youth homelessness and, more recently, biodiversity.¹⁰⁷ SIBs have mostly been contracted in high-income countries – particularly the UK and US – but developing country governments are becoming increasingly active in the sector. For instance, in 2017 Colombia became the first middle-income country to launch a SIB, but others are in the design stages in South Africa, Brazil and Mexico.

Development impact bonds operate on the same basis as SIBs, but are primarily designed to be used in developing countries where a development agency or philanthropic foundation pays for the contracted developmental outcome.

Mode of Operation

Impact bonds can be structured as standalone contracts, or as part of an impact bond fund that issues multiple contracts under the same or related social issue. Both cases typically involve three key actors: (i) investors who provide up-front capital for the project; (ii) service providers that implement the project; (iii) and outcome funders (also known as payors) who return the invested capital plus an agreed return in the event of success. In the case of SIB funds, a rate card is used to specify the rate at which the outcome funder will pay for each outcome based on the cost savings realized by the project.

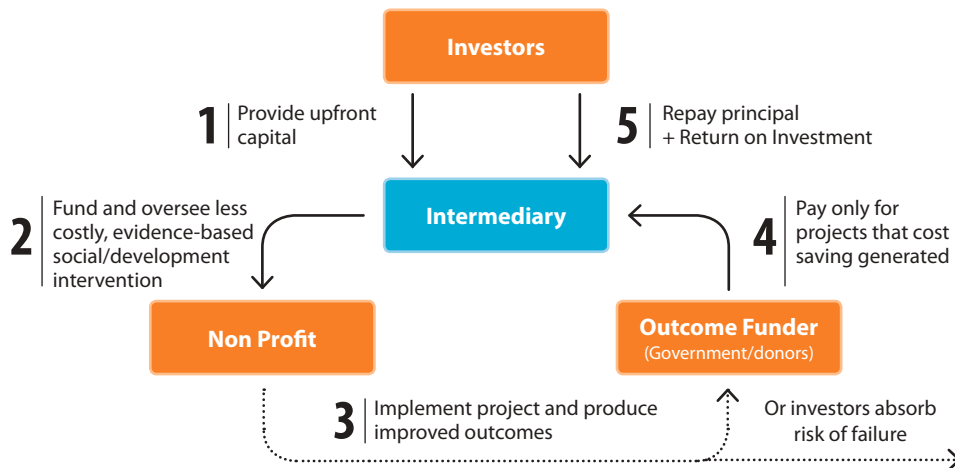
Many outcome funders use intermediaries to raise capital, structure and oversee the contracts on their behalf. In this case, the payor retains an intermediary managing organization whose payment is also contingent on successful implementation of the project. Social Finance is considered the foremost intermediary globally but others include Harvard Social Impact Bond Technical Assistance Lab, Third Sector Capital Partners and Finance for Good. Finally, an independent evaluator is used to assess whether

¹⁰⁷ Gustafsson-Wright et al; Center for Universal Education at Brookings & Convergence; September 2017; Impact Bonds in Developing Countries; Early Learnings from the Field; pp.14-15.



key outcome metrics have been met. The diagram below depicts the stages involved in a typical impact bond contract.¹⁰⁸

Figure 1: Impact Bond Mechanics



Impact Bonds in Action

Ninety SIBs have been contracted globally to date.¹⁰⁹ The majority of SIBs in high-income countries are for employment interventions (38 percent) followed by social welfare (31 percent), typically for at-risk populations such as ex-offenders, vulnerable youth and refugees.¹¹⁰ By contrast, health dominates impact bond interventions in developing countries, accounting for nearly 40 percent of the 28 bonds in operation or in development, followed by employment (21 percent), agriculture (18 percent) and education (14 percent).¹¹¹ As with most development interventions, impact bonds in developing countries target low-income groups, especially those that are vulnerable or marginalized. For example, the Colombia Workforce Development SIB targets high school graduates aged 18 – 40 who are not formally employed, are nationally classified as extremely poor and have been displaced by armed conflict.

The three DIBs that have been contracted to date also underscore these funding preferences. The Educate Girls DIB in India seeks to boost enrolment for 9000 out-of-school

¹⁰⁸ Adapted from: <https://www.forbes.com/sites/jonhartley/2014/09/15/social-impact-bonds-are-going-mainstream/#5dc988f46306>

¹⁰⁹ Ibid; p.14.

¹¹⁰ Ibid; p.16.

¹¹¹ Ibid.



girls¹¹²; the Sustainable Cocoa and Coffee Production DIB in Peru, which ended in December 2015, helped 133 families in remote villages in the Amazon improve cocoa harvesting and restore their devastated coffee crop.¹¹³ Finally, the International Committee of the Red Cross Programme for Humanitarian Impact Investment (PHII) has raised 26 million CHF to fund three physical rehabilitation centres for disabled survivors of conflict in Democratic Republic of Congo, Mali and Nigeria.¹¹⁴

Among DIBs in the pipeline, the UNDP Global Environmental Facility is one of the outcome funders of the pioneering Rhino Impact Investor Project which aims to combat illegal wildlife trade. The initiative will test the feasibility of using impact bond structures to finance conservation projects initially in South Africa, Kenya and Nepal, with the goal of devising a replicable funding model that can be applied in other countries. UNDP is also working on the technical outline of a Tobacco Social Impact Bond (TSIB) that will seek to support farmers to diversify away from tobacco cultivation.

Results to Date

Impact bonds are still a work in progress and it is too early to judge how effective they will be in raising significant additional financing for development, and in delivering improved development outcomes. To date the size of the market stands at US\$ 322 million;¹¹⁵ it is therefore very small but its growth may accelerate as more, larger-capitalized impact bond funds are launched. For instance, in 2016, the US House of Representatives passed The Social Impact Partnerships to Pay for Results Act that would create a US\$ 100 million SIB fund within the US Treasury.¹¹⁶

Early evidence of the development effectiveness of impact bond partnerships is mixed, even within the same type of intervention. The Peterborough case is widely celebrated as an example of the potential for SIBs to deliver outsized social impact compared with public sector baseline results. The project exceeded its target outcome by reducing reoffending rates by 9 percent compared with the contracted 7.5 percent.¹¹⁷ A similar SIB at Rikers Island prison in New York, failed to deliver the minimum 10 percent reduction in recidivism, resulting in loss of the US\$ 9.6 million investment underwritten by Goldman Sachs and Bloomberg Philanthropies.¹¹⁸ Nevertheless, among SIBs with available performance data 21 (out of 22) reported positive results, 12 made outcome

¹¹² Ibid; p.62.

¹¹³ Ibid; p.64.

¹¹⁴ For more information, see: <https://www.icrc.org/en/document/worlds-first-humanitarian-impact-bond-launched-transform-financing-aid-conflict-hit>

¹¹⁵ For further information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html>

¹¹⁶ For further information, see: <https://www.enterprisecommunity.org/2016/06/increase-federal-support>

¹¹⁷ For further information, see: <http://www.socialfinance.org.uk/wp-content/uploads/2017/07/Final-press-release-PB-July-2017.pdf>

¹¹⁸ For further information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html>



payments, and 4 fully repaid investors.¹¹⁹ Social Finance reports that 113,643 lives have been ‘touched’ by SIBs so far.¹²⁰

Limitations

Most impact bond transactions are currently small and bespoke, which could make it difficult to replicate outcomes in different contexts. Transaction sizes can range from as low as US\$ 110,000 in the Peruvian case, to as high as US\$ 30 million in the case of the South Carolina Nurse-Family Pay-for-Success Project.¹²¹ Deal sizes are lower in developing countries with an average size of US\$ 2 million.¹²² This reflects the high risk for both investors and outcome funders involved in scaling investments without sufficient evidence that impact bond interventions consistently outperform public/donor services and deliver worthwhile financial returns.

On the operational side, impact bonds are difficult and time-consuming to structure, and the frontloaded capital may not reflect the true cost involved after in-kind support and other contributions are factored in. However, these costs are expected to reduce gradually as more expertise is built, and improved standards of evaluation are developed.

Further Information

Research

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http://www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html

¹¹⁹ Ibid.

¹²⁰ For further information, see: <http://www.socialfinance.org.uk/database/>

¹²¹ For further information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html>

¹²² For further information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html>
Gustafsson-Wright et al; Center for Universal Education at Brookings & Convergence; September 2017; Impact Bonds in Developing Countries; Early Learnings from the Field; p.19.



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8. Crowdfunding

Overview

Crowdfunding emerged in the wake of the global financial crisis in 2008 when tighter lending conditions fueled the search for alternative sources of capital for entrepreneurs and early-stage ventures. It is an online method of funding a lump sum investment through a large pool of smaller contributions from individual investors using (typically online) crowdfunding platforms.

The sector has experienced explosive growth in recent years. Crowdfunding raised over US\$ 34 billion in 2015, up from US\$1 billion in 2011,¹²³ driven mainly by the proliferation of crowdfunding platforms in developed countries such as the United States, UK and France, which together generated close to 80 percent of crowdfunding receipts in 2014.¹²⁴

According to the World Bank, global crowdfunding volumes have the potential to reach US\$ 300 billion by 2025,¹²⁵ thanks in part to continuing strong growth in Asia, where crowdfunding investments rose by 320 percent in 2015, albeit from a low base.¹²⁶ Developing countries in general are expected to account for around a third (US\$ 96 million)¹²⁷ of this volume, over half of which is attributed to the industry's potential in China.¹²⁸

¹²³ UNDP: Financing Solutions for Development – Crowdfunding.

¹²⁴ A.Winkler et al; FS-UNEP Collaborating Centre for Climate & Sustainable Energy Finance; August 31, 2015; Crowdfunding – A Significant Contribution to Financial System Development in Developing Countries?; p.4.

¹²⁵ UNDP: Financing Solutions for Development – Crowdfunding

¹²⁶ Ibid.

¹²⁷ Ibid.

¹²⁸ InfoDev, World Bank; 2013; Crowdfunding's Potential for the Developing World; p.10.



Crowdfunding has been used to raise finance for a variety of diverse purposes from disaster relief to clean energy provision. However, it is most commonly used for business and entrepreneurship ventures (40 percent), social causes (20 percent), film and performing arts (12 percent) and real estate (6 percent).¹²⁹ It has also become the second largest source of finance for small and medium-sized enterprises (SMEs) after venture capital, and looks set to become the largest by 2025.¹³⁰

Mode of Operation

There are four main approaches to crowdfunding (see figure below)¹³¹: donations-based; rewards-based, lending-based or Peer-to-Peer (P2P) and equity-based. Donations- and rewards-based crowdfunding are non-financial because funders are not compensated for providing capital. Donations are mostly used for philanthropic giving during humanitarian or personal/family emergencies such as for medical or legal expenses, disaster relief or famine. In contrast, rewards-based crowdfunding is typically used for creative or technology projects where funders are motivated by the promise of some form of special benefit such as early access to the next big tech product or a memento from a celebrity. By contrast, P2P and equity-based crowdfunding (collectively known as crowdfund investing) compensate investors by way of repayment of principal plus interest and ownership rights plus share of profits (or losses) respectively.

An investee or beneficiary initiates the process by choosing an appropriate crowd-funding platform (CFP) depending on their purpose, and creates a campaign for their project or cause. The campaign is often also advertised on beneficiaries' social media to invite potential crowd funders from networks of family and friends. The campaign defines a target amount to be raised, often within a set timeframe (window). In rewards-based crowdfunding, the investee can either choose an All-or-Nothing (AON) CFP such as Kickstarter, where crowd funders' investments are refunded if the campaign fails to meet its target, or a Keep-it-All (KIA) CFP like Indiegogo, where any amounts raised are retained.

CFPs also use third party intermediaries and other service providers to perform credit screening and due diligence or to recover unpaid debts. In some cases, like Kiva Microfunds, the third party is an actual financial intermediary such as a microfinance institution, who, by having 'skin in the game', has an incentive to screen and monitor borrowers. These intermediaries pre-disburse the requested loans and then effectively refinance them with crowdfunding investments on Kiva.

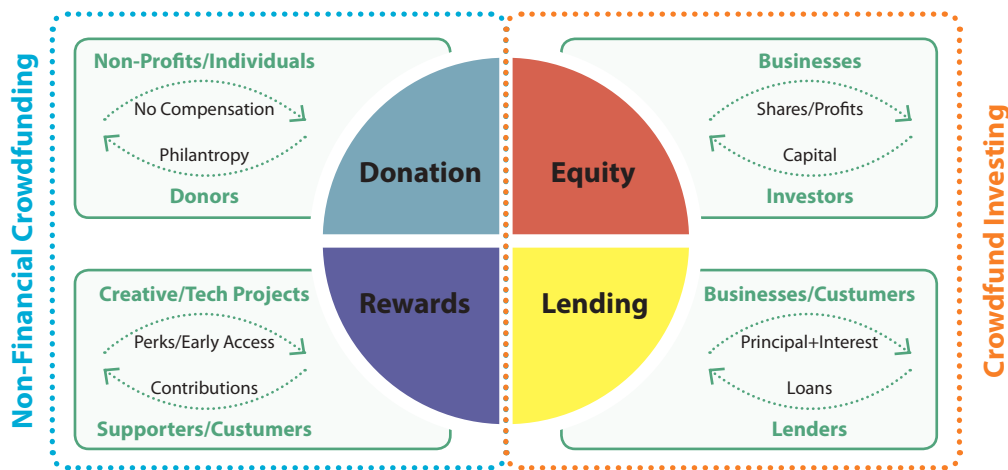
¹²⁹ Ibid.

¹³⁰ Ibid.

¹³¹ Adapted from www.sparkrise.com



Figure 1: Four Main Types of Crowdfunding



Applications in SDG Financing

While philanthropically-motivated donations-based crowdfunding initially dominated the sector's financing volumes, this has been overtaken by crowdfund investing, particularly P2P, which accounted for 73 percent of total crowdfunding volumes in 2015, compared with just 8.4 percent (US\$ 2.85 billion) for donations.¹³² This shift in emphasis means that the focus of the industry has also shifted away from social/humanitarian causes to financial intermediation in mature markets. In developing countries donations still dominate, accounting for 43 percent of the market, closely followed by P2P at 38 percent.¹³³

Several CFPs have distinct development or social agendas. For instance, Kiva has a clear focus on developing countries with Africa, Asia and Latin America (in that order) accounting for the bulk of funded projects in sectors spanning agriculture and retail at the top of the spectrum to construction and health at the bottom. In addition, 83 percent of Kiva's borrowers are women.¹³⁴ The platform has made 1,155,807 loans amounting to US\$ 937 million since it was founded in 2005.¹³⁵ Renewable energy CFPs such as TrillionFund, WindCentrale and Greencrowd are also becoming important sources of SDG financing, raising 165 million for 300 projects in 2015.¹³⁶ UNDP's Crowdfunding Academy has also supported clean energy crowdfunding campaigns in several countries including to fund solar panels for schools in Croatia and Tajikistan, and to provide a solar-powered water pump in Indonesia (see case studies below for more information).

¹³² Ibid.

¹³³ Ibid.

¹³⁴ Ibid.

¹³⁵ Ibid.

¹³⁶ For more information, see: <http://www.recrowdfunding.eu/news-updates/2015/9/14/tracking-renewable-energy-crowdfunding>



Finally, Homestrings is one of the few (for-profit) platforms that focuses on raising funds for infrastructure projects mainly in sub-Saharan Africa. The platform was founded in 2011 and in less than two years of operations, had raised US\$ 25 million for projects in 13 countries.¹³⁷ It counts high profile borrowers such as Government of Kenya and First Quantum Minerals among its investment opportunities.

Disadvantages

Crowdfunding may not be suitable for raising large-scale, long-term financing needed in sectors such as infrastructure or heavy industry. While some campaigns have raised large sums of money, such as the US\$ 23 million raised for victims of the 2015 earthquake in Nepal,¹³⁸ most campaigns are small (under US\$ 4000)¹³⁹ and mainly geared towards consumer lending for creditworthy borrowers. Moreover, success in accessing finance is still very low on all types of platforms. Success rates on non-financial platforms can range from low single digits to around 40 percent, while one study of acceptance rates on LendingClub – the largest P2P platform in the US – found that only 13 percent of loan requests between 2007 and 2012 were approved.¹⁴⁰ Consequently, aggregate funding available through CFPs tends to be lower than available through formal financial intermediaries. For instance, Kiva's outstanding loan portfolio stood at US\$ 44.4 million in 2014, which was around half of the loan portfolio of an average microfinance institution in the same year.¹⁴¹

For borrowers, the cost and accessibility of running online campaigns can be prohibitively expensive particularly in developing countries. CPFs fees can range from zero (Kiva) to between 3 – 8 percent (Kickstarter, Indiegogo)¹⁴² of generated funds, and total marketing costs for large campaigns can be as high as US\$ 17,500.¹⁴³ For CFPs, because of the volume of investors involved in a single transaction, reputational risks from fraud, money laundering defaults and cybersecurity breaches could have more severe consequences, leading to possible spillover and contagion effects for the entire industry.

¹³⁷ InfoDev, World Bank; 2013; Crowdfunding's Potential for the Developing World; p.32.

¹³⁸ UNDP: Financing Solutions for Development – Crowdfunding.

¹³⁹ InfoDev, World Bank; 2013; Crowdfunding's Potential for the Developing World; p.7.

¹⁴⁰ Ibid; p.9.

¹⁴¹ Ibid; p.14.

¹⁴² UNDP: Financing Solutions for Development – Crowdfunding.

¹⁴³ Calculated from data provided in: UNDP: Financing Solutions for Development – Crowdfunding.

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UNDP Mariana Nissen
Cash-for-work activities to jump start the local economy and facilitate the delivery of urgently needed humanitarian assistance



9. Debt-for-nature Swaps

Overview

Debt-for-nature swaps (DNS) leverage funds for use in local conservation efforts, and are based on the model of debt-equity swaps (in which discounted debt is exchanged for investments in the assets of an indebted country). In the case of DNS, the proceeds of the swap are invested in conservation activities within the indebted country.

DNS were first conceived in the 1980s as a means of preserving waning rainforests in South America while simultaneously solving part of the region's sovereign debt crises. Their use has since expanded to other developing countries across Africa, Asia and Europe, particularly those with endangered natural resources. However Latin America and the Caribbean still dominate transactions, accounting for half of the 39 countries where DNS have been implemented.¹⁴⁴

On the creditor side, the US government is the largest benefactor, accounting for around 47 percent of total debt swapped as of 2015. Germany and Switzerland are also significant players contributing 12 percent and 15 percent respectively.¹⁴⁵ Around US\$ 1.2 billion was mobilized through DNS for conservation projects globally between 1985-2015.¹⁴⁶ Australia has participated in debt-for-health swaps while Spain has participated in debt-for-education swaps.

Types of Swaps

Swap agreements differ depending on the creditor(s) involved.

Commercial DNS

In a commercial or third-party DNS a conservation non-governmental organization (NGO), buys part of a country's outstanding debt from a commercial lender on the secondary market at a sizable discount. The NGO then swaps all or part of the face-value of the loan with the debtor-government for 'conservation payments-in-kind'. Organizations such as Conservation International, The Nature Conservancy (TNC) and World Wide Fund for Nature (WWF) are very active in third-party swaps. Conservation International brokered the first ever swap with Bolivia in 1987 when it bought US\$ 650,000 of the country's bank loans for almost 85 percent discount at US\$ 100,000. The debt was resold to the government for a US\$ 250,000 endowment fund to manage 2.7 million acres of rainforest reserve.¹⁴⁷ The figure below is an illustration of the steps involved in a commercial DNS.¹⁴⁸

¹⁴⁴ For further information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/debt-for-nature-swaps.html>

¹⁴⁵ Ibid.

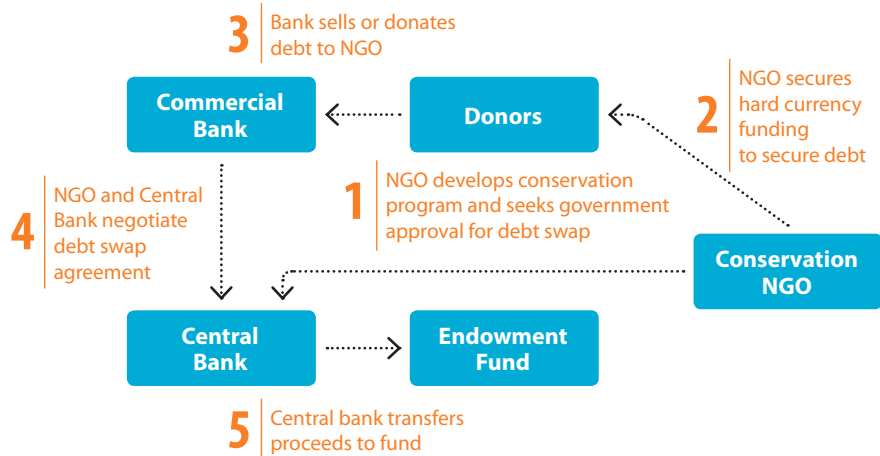
¹⁴⁶ Ibid.

¹⁴⁷ For further information, see: https://web.stanford.edu/class/e297c/trade_environment/photo/hdebt.html

¹⁴⁸ Adapted from https://www.cbd.int/doc/nbsap/finance/Guide_Debt_Nov2001.pdf; p.5.



Figure 1: Steps in a Commercial Debt-for-Nature Swap



This typical commercial DNS structure is considered a triple-win- for all parties involved. Debtor-governments pay off part of their debt at less than face value; conservation organizations achieve greater environmental impact by leveraging additional funds from governments after reselling the debts; and creditors can recover at least part of their otherwise delinquent loans. The endowment fund provides additional assurance that the proceeds of the DNS will be used as intended.

However, these benefits depend on the creditworthiness of individual debtor-governments. Paradoxically, commercial lenders are more likely to accept a higher discount rate on debts if a country's default risk is also high.

Bilateral DNS

Bilateral DNS have been the most common to date, accounting for 93 percent of the value of total global transactions.¹⁴⁹ They are typically negotiated directly between governments in the context of a debt restructuring deal which includes provisions for debt swaps. In 1990, the Paris Club introduced terms that allowed for debt reduction through conversion mechanisms including debt-for-development swaps.¹⁵⁰ However, strict eligibility criteria apply.

In addition, some countries (Canada, Switzerland and the US), have set up special debt conversion programs to implement concessional debt DNS. The largest is the now in-

¹⁴⁹ For more information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/debt-for-nature-swaps.html>

¹⁵⁰ Juan Carlos Vilanova, Matthew Martin, Debt Relief International; 2001; The Paris Club; p.12.



active US Tropical Forest Conservation Act (TFCN), which made US\$ 223 million of bilateral DNS transactions with 14 countries between 1998 and 2013 that are expected to yield US\$ 339 million in conservation finance.¹⁵¹

Bilateral DNS can also be structured as third-party swaps (also called subsidized debt swaps). For instance, in 2016 TNC brokered a bilateral DNS between the government of the Seychelles and Paris Club creditors, which yielded US\$ 22 million to invest in marine conservation.¹⁵² The debt was purchased by the Seychelles' Conservation and Climate Adaptation Trust which was set up to manage the endowment. Other participants in the deal included the DiCaprio Foundation, Oak Foundation and Government of Seychelles-UNDP-Global Environment Facility Programme.¹⁵³

TNC hopes that the Seychellois experience will help revive wider interest in DNS following their relative decline since the 2000s, particularly given the emergence of a strong climate finance agenda in recent years. The value of transactions fell to US\$ 450 million between 2000 and 2010, compared with around US\$ 2 billion in the 1990s.¹⁵⁴ However, the availability of more comprehensive debt relief schemes such as the Heavily Indebted Country Initiative (HIPC) on the official debt side, and the more attractive discounts available on the secondary market for debt on the commercial side, continue to limit the market for future DNS. Many HIPC countries that have recently regained access to external capital markets may also not want to be seen as needing debt relief so soon after the bulk of their debts were cancelled.

Drawbacks

DNS are complex to arrange and costly to administer. As with most debt restructurings, they can take years to negotiate often requiring prior implementation of lengthy IMF stabilization programmes. Transaction costs involved can range between 1.5 percent and 5 percent of the debt's face value in commercial DNS.¹⁵⁵

Domestically, high inflation prevalent in many developing countries could erode the value of local currency endowment funds unless hedged. Political and economic risks such as corruption, mismanagement and fiscal constraints could also impact the ability of the debtor government to make agreed repayments. Finally, incentives for debtor-governments to enter into DNS is limited by the minimal debt relief typically achieved.

¹⁵¹ For more information, see: <https://www.usaid.gov/biodiversity/TFCA>

¹⁵² For more information, see: <https://www.nature.org/ourinitiatives/regions/africa/wherewework/seychelles.xml>

¹⁵³ For more information, see: <http://www.undp.org/content/sdfinance/en/home/solutions/debt-for-nature-swaps.html>

¹⁵⁴ Ibid.

¹⁵⁵ For further information, see: https://www.cbd.int/doc/nbsap/finance/Guide_Debt_Nov2001.pdf; p.9.



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UN Photo Victoria Hazou
Workers fabricate sandals made of recycled tires at Rebuild Globally funded in part by a Quick Impact Project (QIP) grant from the United Nations Stabilization Mission



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