The Economist

WORLD ECONOMIC FORUM

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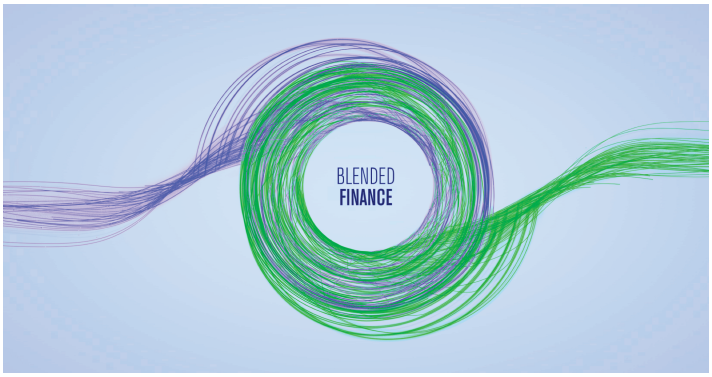
Finance and economics | Apr 23rd 2016

Blended finance | Trending: blending

The fad for mixing public, charitable and private money



MEETING the United Nations' Sustainable Development Goals will require additional investments of $2.5 trillion a year in things like health care and education for the world's poorest people, according to UNCTAD, a UN agency. A further $13.5 trillion is needed by 2030 to implement the Paris climate accord, according to the International Energy Agency, a watchdog group. It is enough to drive development types to drink—which may be how they came up with the term "blended finance", a heady cocktail of public, private and charitable money.

The phrase is being floated at all manner of gatherings, from the recent meetings of the IMF and the World Bank to the World Economic Forum in Davos, as a way to make the limited pool of money available for worthy causes go further. The new name notwithstanding, however, the idea of using public funds to attract private money is a venerable one. For it to change development finance fundamentally, as enthusiasts claim it can, it will have to become easier to scale up.

Private investors do not typically fund the construction of rural roads in Africa, say, or vaccination drives in villages, even though the returns on such investments are often enormous. That is because the returns are either hard to monetise, or the risks are too great for the private sector to tolerate. The point of blended finance is to use public or charitable funds to remedy those problems, allowing private money to flow to places and projects it would usually shun. According to a WEF survey of 74 blended-finance vehicles, this "honey trap" is working: every dollar of public money invested typically attracts a further $1-20 in private investment.

When Wandee Khunchornyakong, a Thai entrepreneur, wanted to build solar farms in sunny north-east Thailand, commercial lenders were unwilling to take a leap into such an untested market. In 2011 the IFC, an arm of the World Bank, provided an $8m commercial loan blended with a low-interest loan of $4m from CTF, a climate investment fund backed by several governments. This gave three local banks the confidence to lend a further $14m. By 2015 the company had attracted $800m of investment, all but the initial loan from the private sector.

AATIF, a $146m fund which invests in sustainable African agriculture, goes even further to protect private investors. It has three categories of shareholders. The first two, comprising the German Ministry of Development, KfW, a development bank owned by the German government, and Deutsche Bank, which also manages the fund, agree to absorb losses before the third tier—consisting only of private investors—gets hit. That means losses have to exceed 50% of the fund's net asset value before investors in the third tranche suffer any harm.

In a similar vein GuarantCo, which is backed by aid agencies, helps make investments in infrastructure in poor countries bankable by taking on the most nettlesome risks. For every dollar it invests it has attracted $13.50 in private money. In 2014 it helped Mobilink, a telecoms firm, expand into remote parts of Pakistan by guaranteeing part of an Islamic bond denominated in Pakistani rupees. The Gates Foundation, too, has put aside $1 billion to provide loan subsidies, guarantees and other sweeteners for twitchy private creditors.

Blended finance can also be used to generate financial returns on investments that would normally only yield less tangible benefits. The most common method is the "social-impact bond", in which "outcome funders", such as governments and aid agencies, pay back investors who have funded projects that meet goals which, although socially desirable and delivering notional cost savings, do not yield direct profits. In one example, Children's Investment Fund Foundation, a charity, has agreed to pay a return of 10% on a project designed to improve school attendance among Indian girls if enrolment, literacy and numeracy improve as agreed after three years. If the results exceed expectations, the return rises to as much as 15%.

Social-impact bonds are promising. But they are still very new, and more discussed by wonks than used in the real world. Kois Invest, an impact-investing firm, counts 60 social-impact bonds launched since 2010, mostly in the rich world. The Indian education bond is financed by a sympathetic lender, the UBS Optimus Foundation, which hopes to prove the financial viability of the concept.

Few data exist on the scale and success of blended finance more broadly, but it is still a niche. Two global platforms were recently launched to match investors with projects. One of them, Convergence, has a database of over 150 blended transactions since 2000 with a total value of $40 billion, but says its list is not exhaustive.

For the industry to grow from the billions to the trillions, it will need more than a catchy name. A larger pool of private investors and more easily replicated projects will be essential. At the moment, for instance, every social-impact bond is tailor-made. The mixologists of development finance have to start preparing their cocktails by the pitcher, not the glass. ■