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Under the overall guidance of

The International Network on Conflict and Fragility (INCAF) and

Rachel Scott, OECD Development Co-operation Directorate

Author

Lydia Poole, Research Associate, Humanitarian Outcomes

Copy editing/proof reading

Yanitsa Dyakova, OECD Development Co-operation Directorate

Jenny Gallelli, OECD Development Co-operation Directorate

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Acronyms

AAAA	Addis Ababa Agenda for Action
AATIF	Africa Agriculture and Trade Investment Fund
ADB	Asian Development Bank
AFD	Agence Française de Développement
ARC	African Risk Capacity
BMZ	German Federal Ministry for Economic Cooperation and Development
CAR	Central African Republic
CCL	Counter-cyclical loan
CCR	Catastrophe Containment and Relief Trust (IMF)
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CERF	United Nations Central Emergency Response Fund
CIV	Collective Investment Vehicle
COP	Conference of the Parties
DRFI	Disaster Risk Financing and Insurance programme of the World Bank
EDF	European Development Fund
EEIP	European External Investment Plan
EFSD	European Fund for Sustainable Development
EITI	Extractive Industries Transparency Initiative
EU	European Union
FAO	United Nations Food and Agriculture Organisation
FDI	Foreign Direct Investment
FGS	Federal Government of Somalia
GCFF	Global Concessional Financing Facility
GDP	Gross Domestic Product
GNI	Gross National Income
HDPN	Humanitarian-development-peacebuilding nexus
IDA	International Development Association (World Bank)
IDB	Islamic Development Bank

IDB	Inter-American Development Bank
IDP	Internally Displaced Person
IFC	International Finance Corporation
IFI	International Financing Institution
ILO	International Labour Organisation
IMF	International Monetary Fund
INFF	Integrated National Financing Framework
IOM	International Organisation for Migration
IFRC	International Federation of Red Cross and Red Crescent Societies
JICA	Japan International Cooperation Agency
MCRB	Myanmar Centre for Responsible Business
MDB	Multilateral Development Bank
MDG	Millennium Development Goals
MENA	Middle East and North Africa
MIGA	Multilateral Investment Guarantee Agency
MSF	Médecins Sans Frontières
OCHA	United Nations Organisation for the Co-ordination of Humanitarian Affairs
OECD	Organisation for Economic Cooperation and Development
ODA	Official Development Assistance
OfD	Oil for Development (Norway)
OOF	Other Official Flow
PCDR	Post-Catastrophe Debt Relief Trust (IMF)
PCRAFI	Pacific Catastrophe Risk Assessment and Financing Initiative
PEF	Pandemic Emergency Facility
PIDG	Private Infrastructure Development Group
PPP	Public-private partnership
PSW	Private Sector Window (IFC-MIGA)
SBC	State Building Contracts
SDG	Sustainable Development Goals
SECURE	Stand-by Emergency Credit for Urgent Recovery (JICA)
SME	Small and medium-sized enterprise
TOSSD	Total Official Support for Sustainable Development
UNEP	United Nations Environment Programme

UNFPA	United Nations Population Fund
UNHCR	The Office of the United Nations High Commissioner for Refugees
UNICEF	United Nations Children's Fund
WEF	World Economic Forum
WFP	United Nations World Food Programme
WHO	World Health Organisation
WHS	World Humanitarian Summit

Executive summary

This study and its associated guidance contribute to advancing thinking and understanding about one of the most significant challenges that the international community faces in fragile contexts: how to provide the right financing.

The paper summarises new and emerging instruments and approaches in financing stability and resilience, and points to some of the gaps and challenges that remain in the fragility, resilience and stability space. It is not intended as holistic policy guidance on “how to” engage effectively across international and domestic, public and private instruments in fragile contexts. Instead, the paper is complemented by separate guidance on financing strategies: approaches to better align financing to support the delivery of results at the country-level.

The research acknowledges that there are many high-level strategic debates which have yet to be resolved, which concern the comparative advantage and future role of Official Development Assistance (ODA) within a more diverse division of labour in financing, as well as a huge range of technical and capacity challenges ahead. The analysis, observations and conclusions put forward in this study should be interpreted therefore as preliminary contributions to what is a live and dynamic process of debate and adaptation.

Key Message 1: The aspirations of the Addis Ababa Action Agenda (AAAA) require an updated approach to bringing together financial flows from public and private, and domestic and international sources. Nowhere is this more so than in fragile contexts with the greatest potential risks, and the greatest potential returns.

In the future, development finance is expected to play a more targeted role in addressing critical financing gaps, especially where markets, governments and civil society are unlikely to step in, and by creating incentives and enabling conditions. In this new financing paradigm, development finance should be used strategically to:

- Catalyse investment from other public and private sources by offsetting investment costs and/or reducing risk to investment capital, and promoting domestic resource mobilisation;
- Incentivise desirable behaviours (such as appropriate management of risk; prioritising governance, economic and public policy reforms; better management of domestic resources, budget allocation and execution; co-ordination; inclusion; and transparency);
- Underwrite public goods at the country, regional and global-level, which might otherwise struggle to attract investment (and which in turn may enable peace, stability, economic development, and environmental protection);
- Actively mitigate risks to stability by reducing the impact of financial and economic shocks and stabilising deteriorating governance and security situations; and
- Provide safety-nets for the most vulnerable and those exposed to shocks.

Key Message 2: New instruments to manage risks to stability and respond to shocks and opportunities are emerging, but there are still too few incentives to ensure adequate and sustained investment in prevention, preparedness, resilience, peacebuilding and other public goods.

Recognising the substantial potential returns on public and private investments in sustaining peace, a new generation of shock- and opportunity-responsive financing instruments is emerging, designed to help respond rapidly to deteriorating situations or to new opportunities for political and economic reform, stabilisation or peace. A global conceptual shift and better understanding of risk has also led to the emergence of a diverse ecosystem of instruments to manage and respond to risk. And the long-standing policy demand for flexible financing in fragile and crisis affected situations is beginning to deliver a new generation of instruments and flexible approaches spanning the humanitarian-development-peacebuilding nexus. However, despite this growing sophistication in the global financing tool-kit, key public goods – such as prevention, risk management, peacebuilding and preparedness – remain largely funded on an ad hoc basis and consistently struggle to attract adequate investment.

Key Message 3: The use of development finance to leverage or mobilise private sector investment is an area of growing interest, but in high-risk and low capacity fragile environments, a dose of realism and a cautious approach are required.

Hopes are pinned on blended finance as a means to help bridge the Sustainable Development Goals' (SDG) investment gap. Yet blended finance is not strongly concentrated in the poorest or most challenging contexts and tends to target a limited range of sectors. And while blended finance may provide a partial solution to private sector investment challenges, offsetting risks and reducing the costs of investments, it does not alter underlying market fundamentals and, particularly in fragile contexts, some would argue that the potential for modest ODA investments to leverage private sector resources may be overstated. In addition, development financing actors who operate on a commercial basis face limits to the level of risk they can reasonably accept while protecting their balance sheets. Therefore, in fragile and crisis-affected contexts, there is a strong argument for focusing development finance on broader and longer-term public investments and macroeconomic reforms, supporting the development of pipelines of investable projects, and strengthening the investment enabling environment, before attempting to crowd in private funds.

Key Message 4: Increased diversity in financing sources and actors brings risk and complexity as well as opportunity: new and revised norms, standards and codes of behaviour and practice are needed to reduce the risk of doing harm.

In order to scale up public and private investments and apply a more diverse financing tool-kit in fragile contexts, development financing actors will need to invest in new technical capabilities, increased physical presence or proximity, and more holistic and robust approaches to understanding and managing risk and the impacts of investments. Updated standards, codes, guidance and monitoring tools are needed to ensure public and private investments meet priority financing needs, without inadvertently causing harm. Development financing actors in fragile contexts will need to retain a sharp focus on the developmental benefits and sustainability of outcomes, especially when working with the private sector, to avoid creating inappropriate and unsustainable investments, market distortions, environmental damage, and social and political problems. Promoting and supporting the capacity to enforce and hold public and private sector actors to account against international standards for responsible business will be a key role for development actors in future. In addition, supporting improved domestic resource mobilisation and the management of an increase in public investments will be central to economic stabilisation and to rebuilding government legitimacy.

Key Message 5: At the country-level, effective targeting of resources requires new and additional investment in risk and context analysis, and financing strategies to match resources with priorities and plans.

Ensuring the right amount of financing is available for the right length of time, in a manner that delivers the right incentives for peace and sustainable development, is not only a matter of having the right tools at the global level, it also requires the ability to target and tailor financing to the needs, priorities and dynamics of the context. Country-level financing strategies are rapidly gaining in popularity as a practical approach to help navigate growing complexity in the financing landscape, to look beyond immediate financing gaps to match a range of financing actors and flows to strategic development, peacebuilding and resilience goals over a medium- to long-term timeframe. Comprehensive country-level financing strategies are not yet a part of planning and prioritisation packages however, and will require a range of incentives and targeted investments to ensure their routine use in fragile, crisis-affected and at-risk contexts.

Key Message 6: Shifting towards an "investment" culture and practice for public and private finance in fragile contexts requires a major conceptual shift as well as reforms, upgrades and investments in the capacities of international financing actors.

Working effectively in higher-risk and unpredictable contexts requires the capacity for critical dialogue with partners and a management culture that incentivises learning and tolerates altering course – all of which has implications for staffing levels, skills, and the distribution of decision-making authority. While many institutions have signalled their commitment to work to address the challenges of fragility, crisis and risk, so far, few have significantly increased their staffing capacities at country or regional level, altered their management approaches to enable flexible, risk-tolerant approaches at the country level, or embedded institutional incentives to work collaboratively.

Key Message 7: In contrast with signals and practical steps towards change in policy and tool-kits, the current global political environment, modest global growth, and growing exposure to risk threatens existing development gains and reduces opportunities for further progress.

Several years of global economic slowdown and a modest bounce-back is dampening hopes of harnessing the financial resources and job-creating capabilities of the private sector to deliver development gains and economic growth. The current global growth trajectory is not expected to deliver the eradication of extreme poverty by 2030, and the least developed countries are expected to fall well short of this target. Meanwhile, the immediate political priorities and agendas of bilateral donors are potentially in tension with sustainable development, peacebuilding and climate change policy commitments in several areas.

The political, financial and intellectual support of bilateral donors both directly, and within their respective roles as governing members and shareholders of multilateral institutions, will be critical for stimulating and enabling change and helping to shape global norms and standards for better programming and financing in fragile contexts. During this dynamic period of reflection, reform and innovation, and in the context a challenging political and economic environment, the continued engagement and support of development financing actors, including INCAF members, will be critical to ensuring that changes support the needs and priorities of people affected by crisis, fragility and risk: some of those most left behind.

Introduction

Getting the financing right will be critical for the success of Agenda 2030

The scope of international humanitarian, development and peacebuilding actors has altered significantly under the 2030 Agenda for Sustainable Development, and international financing will need to adapt to enable this change. The Sustainable Development Goal (SDG) aspiration to *leave no one behind* requires a major shift in the geographical and demographic focus of sustainable development financing. Within the next five years, most the world's poorest are expected to live in states affected by fragility (Milante et al, 2016)[1], yet these are the most challenging environments for external actors to operate effectively in.

At the same time, the scope of action and engagement envisaged under the SDGs is broader than that under the Millennium Development Goals (MDGs); with SDG Goal 16, *Promote just, peaceful and inclusive societies*, formally acknowledging peace and security as a necessary field of action and a precondition for sustainable development. In addition to a shift in emphasis in international humanitarian, development and peacebuilding policy, the need to work differently received renewed emphasis in the UN Secretary General's 2016 *Agenda for Humanity*, which establishes commitments to work with greater coherence and complementarity towards collective outcomes, focused on ending humanitarian needs and reducing risk and vulnerability (UN, 2016).

The need to mobilise, target and co-ordinate a far wider range of investments to meet collective sustainable development objectives found formal recognition in the 2015 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (AAAA), and many development financing actors have subsequently invested a great deal of intellectual and institutional resources in adapting to the challenge. The AAAA recognised the importance of focusing concessional financing on those with the greatest needs and the least ability to mobilise other resources, and notes concern that the share of ODA allocated to the least developed countries had in fact declined (UN, 2015). The AAAA encourages ODA providers to consider setting a target of providing at least 0.2 per cent of ODA/GNI to the least developed countries (ibid.). For many donors, this would mean a substantial scaling up of their spending in some of the most high-risk and challenging settings.

Not only does the AAAA envisage aligning all financing flows and policies to support sustainable development, it also points towards a more targeted and specialised role for development financing, addressing critical financing gaps where others are unlikely to step in – notably for building climate and disaster resilience, and crisis response,[2] and regional and global public goods, including peacebuilding.[3] The potential for development finance to play a key role in catalysing resources for sustainable development from the public and private sectors was also recognised, including investing in the enabling conditions for sustainable economic growth, reducing risks to private capital investment, and the mobilisation and effective management of public financing.[4]

Meanwhile, risks are increasing and many challenges stand in the way of progress

In contrast with the expanded ambitions of Agenda 2030, the current global political environment, modest global growth, and growing exposure to risk, threatens existing development gains and reduces opportunities for further progress. Despite upwards revisions of aggregate growth forecasts, global economic growth remains "modest" and a range of medium-term structural economic weaknesses and risks have yet to be addressed by policy-makers (IMF, 2017). Rising levels of indebtedness among most fragile and at-risk states imply higher levels of vulnerability and a challenge to their stability and growth prospects as their average debt-to-GDP ratio has risen steadily from 37.5% in 2012 to a projected 50.5% in 2017.[5] Modest economic growth poses a substantial challenge to aspirations expressed in the AAAA, to harness the financial resources and job-creating capabilities of the private sector to deliver development gains and economic growth. Indeed, recent projections indicate that global economic growth will not deliver the goal of eradicating extreme poverty by 2030 and the least developed countries will fall far short of this target (UN, 2017).

Meanwhile, the costs of violence, displacement and climate-related risks continue to grow. Levels of violence have increased in recent years, including new types of violence that are less easily managed with traditional political, security and peacebuilding tools, and violence is occurring in unexpected places, notably in upper-middle-income countries and increasingly in urban settings (OECD, 2016). Low-income countries with hotter climates are expected to be most adversely affected by negative impacts of climate change, including reduced economic output and exposure to weather related hazards and shocks (IMF, 2017).[6] Moreover, violence, shocks (including disasters, disease outbreaks and pandemics and economic crises) and their impacts are more readily transmitted in an increasingly interconnected world, further increasing the scope and scale of risk.

Fragile contexts are risky and challenging for development finance actors

Development finance actors face unprecedented challenges in achieving Agenda 2030 objectives while working in the most challenging and risky environments, in an uncertain global political and economic climate. Development financing actors are looking to broaden the scope of funding, and the tools and instruments available to them, but an array of unresolved and sometimes profound challenges remain, undermining the effective co-ordination, sequencing and layering of investments targeted towards development, humanitarian, climate change and peacebuilding goals. Unfortunately, these challenges are likely to multiply as a more diverse cast of actors and instruments and new areas of potential risk emerge. Many of the finer details of instruments and approaches to using ODA to incentivise and leverage other flows, including how best to target, design, co-ordinate, partner, monitor and measure developmental impact, are yet to be resolved. In addition, the potential risks of extending new financing instruments and approaches into higher-risk fragile and crisis-affected contexts are perhaps not yet fully understood. Meanwhile more nuanced thinking is emerging around the root causes of violence and fragility, which pose major challenges to existing policy orthodoxy and to the investment priorities, approaches, tools and instruments at the disposal of international actors (OECD, 2016).

This study aims to support improved development finance for fragile contexts

Against this backdrop of substantial shifts at the global policy level, and as part of commitments by the OECD and the International Network on Conflict and Fragility to support improved co-ordination and management of development finance for greater impact, especially in fragile contexts, this study and its associated tools and guidance are intended to contribute to advancing thinking and understanding around the nature of the financing challenges in meeting the aspirations of the AAAA in the context of fragile, conflict affected and at-risk settings. This policy study is part of a wider research project which includes a series of products that collectively aim to:

- expand on the nature of current financing challenges in fragile, conflict-affected and at-risk contexts
- draw practical lessons from the experiences of development financing actors in attempting to manage these challenges, and point to potential future risks and challenges
- make practical recommendations for financing actors on how to support the emergence and delivery of more comprehensive financing strategies at the country level, and
- identify and fill gaps in the global financing landscape.

The research draws on an extensive literature review, a series of semi-structured interviews at the global level and a series of country case studies, which included two in-country visits to Lebanon and Myanmar that involved extensive discussions with country-level decision-makers and financing actors.

The term stability in this study describes where locally legitimate authorities and systems can peaceably manage conflict and prevent a resurgence of violence.[7]

This study considers financing challenges at the global-level and is complemented by guidance on financing strategies: approaches to better align financing to support the delivery of results at the country-level. The research acknowledges that there are many high-level strategic debates which have yet to be concluded concerning the comparative advantage and future role of ODA within a more diverse division of labour in financing, as well as a huge range of technical and capacity challenges ahead. The analysis, observations and conclusions put forward in this study should be viewed as preliminary contributions to a live and dynamic process of debate.

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Notes

[1] Milante (2016) that under a 'base case' projection, by 2030, one approximately two-thirds of the world's poor would reside in countries classified as fragile by the OECD in 2016.

[2]"We encourage consideration of climate and disaster resilience in development financing to ensure the sustainability of development results. We recognise that well-designed actions can produce multiple local and global benefits, including those related to climate change. We commit to investing in efforts to strengthen the capacity of national and local actors to manage and finance disaster risk, as part of national sustainable development strategies, and to ensure that countries can draw on international assistance when needed." (UN, 2015).

[3] "We recognise the peacebuilding financing gap and the role played by the Peacebuilding Fund. We will step up our efforts to assist countries in accessing financing for peacebuilding and development in the post-conflict context." (UN, 2015).

[4] "It can support improved tax collection and help to strengthen domestic enabling environments and build essential public services. It can also be used to unlock additional finance through blended or pooled financing and risk mitigation, notably for infrastructure and other investments that support private sector development." (UN, 2015).

[5] Indebtedness data supplied directly by IMF, and then analysed using the OECD 2016 fragile states list. Data for 2017 is projected. No data available for Democratic People's Republic of Korea, Libya, Somalia, Swaziland, Syria, Timor-Leste, West Bank and Gaza Strip.

[6] "For the median emerging market economy, a 1°C increase from a temperature of 22°C lowers growth in the same year by 0.9 percentage point. For the median low-income developing country, with a temperature of 25°C, the effect of a 1°C increase in temperature is even larger: growth falls by 1.2 percentage points…..And even though countries projected to be significantly affected by an increase in temperature produced only about one- fifth of global GDP in 2016, they are home to close to 60 percent of current global population and more than 75 percent of the projected global population at the end of the century." IMF, 2017.

[7] Definition provided by USAID.

Chapter 1. What makes financing for crisis-affected, fragile and at-risk contexts so difficult?

Attracting the right international finance for diverse, high risk, fragile contexts is difficult

Crisis-affected, fragile and at-risk contexts are highly diverse in terms of capacity, income levels, security, exposure and vulnerability to risk, and commitment to development. There is no standard set of characteristics or accompanying policy prescriptions for situations affected by fragility, violence or risk. A number of countries which might be considered “at risk”, or which are affected by mass displacement or violence at a sub-national level, may in fact be upper-middle-income countries with relatively advanced economies and governance capabilities at the macro or national level. However, there are common elements in many contexts that pose challenges to development financing approaches and instruments, which are worth noting.

Environments affected by violence and institutional fragility are much more likely to pose higher risks for external financing investments. Such contexts are susceptible to inflation, currency depreciation, limited regulation (Box 1.1), limited enforcement of property rights and may have suffered destruction of infrastructure and other assets. Both public and private financing actors continue to struggle to adapt their approaches and instruments to balance the realities of the challenges faced against institutional expectations for returns on investments and management of risk.

Box 1.1. Extreme market deregulation in Somalia

Somalia faces a set of economic dynamics found in few other countries. The country’s dependence on external revenues is extremely high, with remittances and international aid playing a major role in financing its large trade deficit. Somalis received an estimated USD 1.4 billion in remittance inflows in 2014, which represented 24% of gross domestic product (GDP) and was almost double the volume of development funds (USD 642 million) received that year.

Private enterprise has flourished for some in the completely deregulated market conditions prevalent in Somalia since the outbreak of civil war in 1991, particularly in livestock, remittance services and telecommunications. However, the anti-competitive behaviour that prevailed during the war and the continued resistance to market regulation from dominant and monopolistic market actors mean that establishing new businesses and expanding small and medium-sized ones is extremely challenging. Illicit private enterprise has also flourished, notably piracy, which in the six years from the first known hijacking in 2005 up to 2011 is thought to have netted some USD 315-385 million.

Despite superficially encouraging indicators such as high levels of mobile phone penetration and access to money transfer services, and the falling prices of such services, markets are fundamentally dysfunctional for consumers and are dominated by monopolies, in many cases with criminal links, and extremely high levels of insecurity consistently frustrate small-scale food production and trade for ordinary Somalis.

Sources: Do (2013); Randa et al. (2015); World Bank, (2017).

Historically, international humanitarian, development, climate change and peacebuilding actors have been fragmented in their approaches and the management of risk is often an afterthought. Conceptual and operational incoherence between humanitarian and development actors, resulting in sub-optimal outcomes for crisis-vulnerable people, has been the subject of policy debate and reform efforts since at least the early 1990s (Mowjee, Garassi and Poole, 2016). The quest for coherence across development and humanitarian action is a prominent theme of the UN Secretary General’s Agenda for Humanity (UN, 2016) and the Grand Bargain, a set of commitments announced at the World Humanitarian Summit in 2016 to strengthen financing for humanitarian action. Incoherence spreads far wider than the humanitarian-development nexus however. Climate change and peacebuilding have emerged as significant fields of international action alongside more traditional humanitarian and development interventions, with each field bringing separate needs and risk analysis, planning, financing and programming tools and approaches. Coherent approaches to understanding and responding to complex and connected risks are rare – notably, environmental and climate risks are not flagged as priority issues in fragility assessments and Peace and Statebuilding Goals of the G7+ countries, while climate vulnerability assessments rarely address drivers of fragility and transboundary risks (Rüttinger et al. 2015) – despite growing evidence of the strong connection between climate and fragility risks (Box 1.2).

Box 1.2. Compound climate-fragility risks

An independent report commissioned by G7 members in 2016 identifies seven compound climate-fragility risks which pose serious threats to future stability and which require integrated responses:

1. ***Local resource competition:*** as the pressure on natural resources increases, competition can lead to instability and even violent conflict in the absence of effective dispute resolution.

2. ***Livelihood insecurity and migration:*** climate changes will increase livelihood insecurity for those dependent on natural resources, which could push them to migrate or turn to illegal sources of income.

3. ***Disasters, vulnerability and fragility:*** Extreme weather events and disasters will exacerbate fragility and can increase people's vulnerability and grievances, especially in conflict-affected situations.

4. ***Volatile food prices and production:*** Climate change is highly likely to disrupt food production in many regions, increasing prices and market volatility, and heightening the risk of protests, rioting, and civil conflict.

5. ***Transboundary water management:*** Transboundary waters are frequently a source of tension; as demand grows and climate impacts affect availability and quality, competition over water use will likely increase the pressure on existing governance structures.

6. ***Sea-level rise and coastal degradation:*** Rising sea levels will threaten the viability of low-lying areas even before they are submerged, leading to social disruption, displacement, and migration, while disagreements over maritime boundaries and ocean resources may increase.

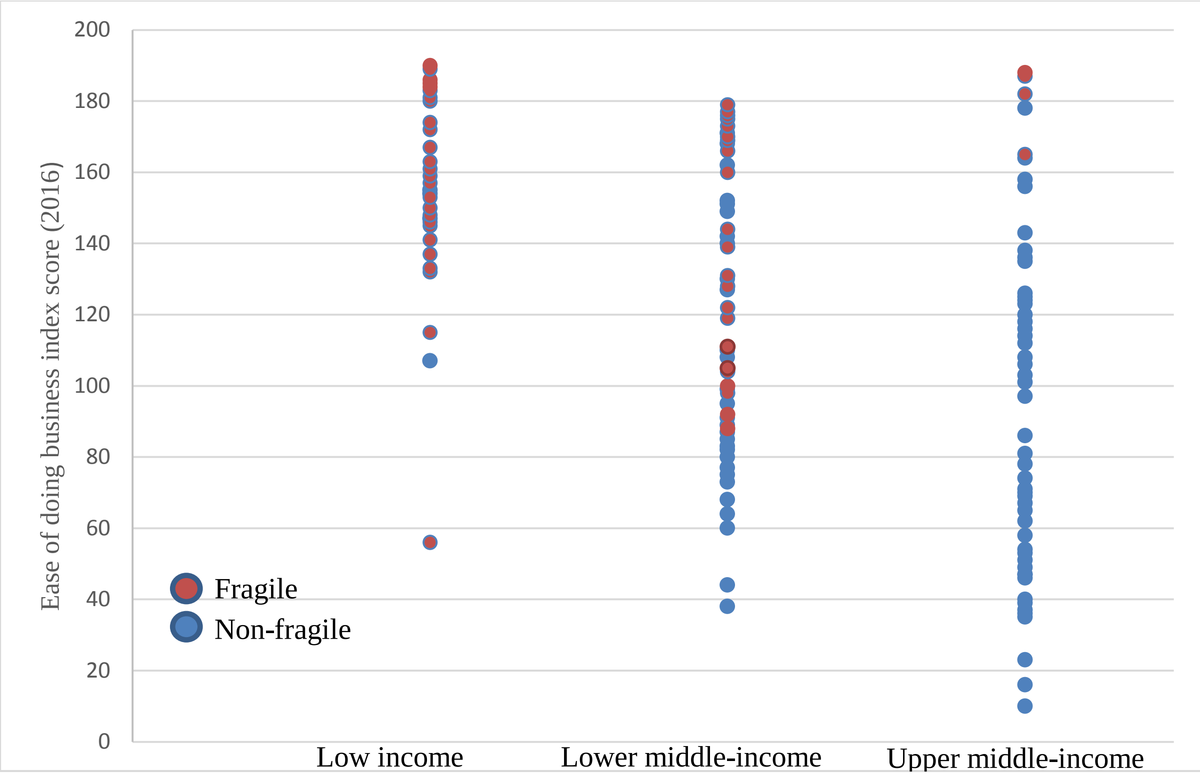
7. ***Unintended effects of climate policies:*** As climate adaptation and mitigation policies are more broadly implemented, the risks of unintended negative effects—particularly in fragile contexts—will also increase.

Source: Rüttinger et al. 2015

There are substantial barriers to private sector investment

The domestic private sector may be inefficient, largely informal, and enmeshed with powerful political interests. States affected by violence and fragility often suffer from significant infrastructure deficits, poorly regulated markets and low levels of enforcement of property rights and contracts, and overall function inefficiently at a "low-level equilibrium" (g7+, 2015), while domestic demand is limited by poverty, insecurity, regular income shocks and a lack of access to financial services. They are often among the most difficult environments in which to start and operate a business (Figure 1.1). In addition to capacity constraints and practical obstacles to markets functioning efficiently, the political economy of the private sector often reflects wider patterns of violence, exclusion and inequality.

Figure 1.1. Ease of doing business in low and middle-income fragile and non-fragile states in 2016



Source: Based on World Bank Ease of Doing Business Index 2016, http://www.doingbusiness.org/rankings; World Bank income group classifications, December 2017; and countries designated as affected by fragility and violence in the OECD's 2016 classification.

These are fundamentally difficult environments in which to mobilise and attract external private financing. In fragile, crisis-affected and at-risk contexts, investment opportunities are often limited in practice, being subject to high levels or risk, volatility, a shortage of partners and of viable investment projects (Leo et al., 2012) and high costs of doing business, owing to infrastructure constraints, inefficient business regulation procedures and low levels of skilled domestic labour.

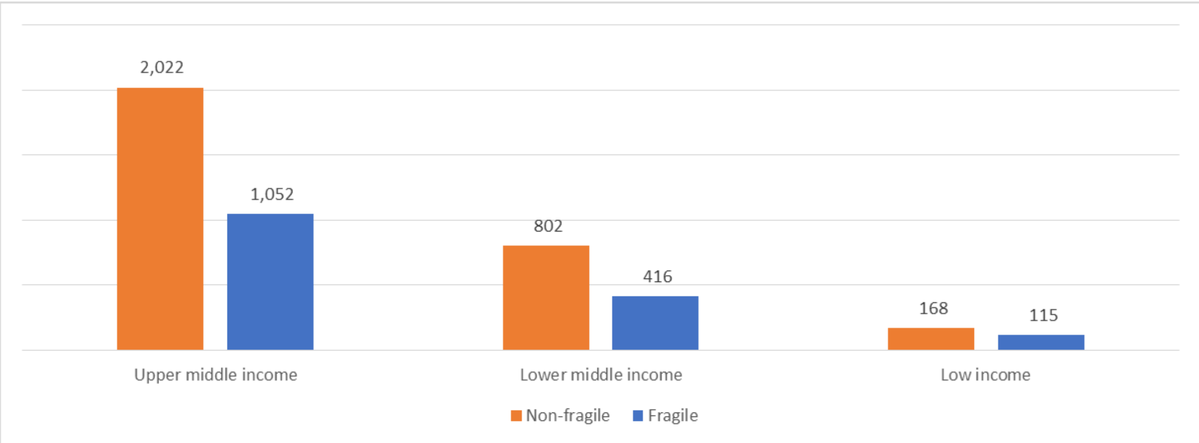
Public sector investment to alleviate risks and constraints on private sector-led investment, job creation and growth faces a range of practical and political risks and difficulties. The public policy environment in many fragile and resource-constrained contexts may be extremely challenging: fiscal space and political appetites for public investment, regulation and curbs on corruption may be highly contentious and decision makers may not follow predictable or seemingly rational patterns of behaviour. Large proportions of national budgets may be diverted to managing security concerns. For example, Iraq currently faces major fiscal deficit in 2017 as a result of diverting resources to the military campaign against ISIS, which in combination with a fall in the price of oil – Iraq's primary source of revenue – has resulted in scaling back of social service provision, and cuts to civil servants' salaries. Budgetary resources may often be allocated to priorities that are more difficult to discuss openly with development financing partners, such as ensuring the political support of certain constituencies or maintaining the patronage benefits of actors who might otherwise threaten stability (Long and Welham, 2016). Budgetary processes may be highly contested. In Lebanon, for instance, in 2016 a national budget was submitted to the cabinet for the first time in ten years. From 2005, "paralysis in decision-making" prevailed as political actors failed to reach consensus on key policy decisions in a power-sharing system where sectarian groups - often led by former militia members and warlords - became de facto "states within states" and had the power to veto policies that worked against their own political and economic interests, including their capacity to maintain their patronage networks (Le Borgne and Jacobs, 2015).

Planning ahead and making major resource commitments in contexts exposed to risk, political uncertainty and economic volatility (including where economies are undiversified and revenues may fluctuate widely) may not in fact be a rational strategy (Long and Welham, 2016). Similarly, well-intentioned international efforts to support technical reforms in the public sector are unlikely to deliver transformative change if they do not understand or indeed work against the informal "rules of the game" which govern access to and incentives within institutions (Jackson and Minoia, 2016).[1]

Domestic public investments in stability are constrained by limited resources

Domestic revenue collection also faces serious challenges. For example in middle-income settings, on average, governments of non-fragile states mobilised nearly twice the revenues of fragile states, and in low-income settings, governments of non-fragile states mobilised 47% more in revenues than governments of fragile states (see Figure 1.2). Many low-income fragile and crisis-affected states have poorly diversified economies and therefore a narrow tax base, combined with limited revenue collection capabilities. Consequently, they may be more vulnerable to macroeconomic shocks and in some cases are also exposed to large-scale natural hazards, which periodically result in economic shocks and large bills for recovery and reconstruction. A number of fragile and crisis-affected states, including some middle-income states, have economies dominated by extractive industries, which provide significant opportunities for rent seeking and diversion of potential revenues, which can fuel grievances and conflict.

Figure 1.2. Average general government revenues per capita in fragile and non-fragile settings in 2016



Source: Based on IMF World Economic Outlook data, April 2017 and population estimates from the UN Department of Economic and Social Affairs. Countries designated as affected by fragility and violence in the OECD's 2016 classification. Note that data is not available for the Democratic People's Republic of Korea (DPRK), Somalia, Syria and Kosovo.

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Notes

[1] Jackson and Minoia (2016) argue that in Afghanistan the international community pursued technocratic approaches and institutional investments which performed very poorly because they ignored the fact that these institutions were largely closed systems and that their recommended approaches effectively asked network actors to work against their own short-term interests and against the "rules of the game", with little potential benefit.

Chapter 2. Emerging concepts, tools, instruments and approaches

Finally, reforms are leading to new and innovative tools for fragile contexts

Earlier efforts at reform failed to bring about substantial changes in financing tools and approaches for situations affected by fragility and risk. Despite consensus at the global policy level on the particular challenges and best-practice approaches to investing in peacebuilding and development in fragile and crisis-affected contexts, internal institutional counter-incentives, competition and genuine operational challenges at the country level have meant that in reality, upgrades and modifications to instruments, tools and approaches have lagged behind policy aspirations. For example, after four years of implementation, monitoring of the Principles for Good International Engagement in Fragile States adopted by OECD ministers in 2007, found significant gaps in institutional capabilities to deliver against policy commitments,[1] and many of the OECD's 2010 recommendations for transition financing remain unfulfilled (OECD, 2010). Similarly, the New Deal for Engagement in Fragile States, which affirms a global policy consensus to place peacebuilding and state-building at the heart of development efforts in fragile states, had disappointed fragile states in particular with its lack of progress against key commitments – notably harmonisation and use of country systems (IDPS, 2014).[2] [3]

Following an extended period of incremental change in financing for situations of risk and fragility, the pace of change has now accelerated. The new global policy consensuses on peacebuilding, sustainable development, climate change and crisis response, together with a number of external push factors – including high-profile, large-scale crises – has provided a major impetus to reform and innovation (Box 2.1). Many concrete changes, including major adjustments in spending priorities and new tools, instruments, approaches and partnerships, are emerging or are under development. It is also notable that it is multilateral actors who are leading much of the innovation in financing tools, instruments and approaches, drawing on their in-house technical expertise and convening power.

Box 2.1. Drivers of institutional change in development financing institutions and actors

Many of the institutions interviewed for this study indicated that a combination of internal and external drivers had contributed to changes in institutional approaches and policies, and to the development of new tools and instruments for fragile contexts. These include:

- **Shifting global policy norms and new commitments:** The normative impact of Agenda 2030 has been substantial. Many financing institutions have undertaken formal reviews of their policies and instruments in light of the new challenges posed by the SDGs, particularly the aspiration to *leave no one behind*. The role of the private sector in mobilising financing for development has gained prominence in the Financing for Development policy debate, leading to a rebalancing of some aid allocations in favour of private sector growth and investment and the expansion or creation of new instruments and approaches. For humanitarian actors, the commitments made under the Grand Bargain in 2016 have stimulated much policy debate and are beginning to drive change in financing practices.

- **Scheduled institutional reviews and learning:** Scheduled policy reviews have in some cases been key opportunities for change in approaches and instruments. For example, the World Bank Group's replenishment of the International Development Association (IDA) under IDA18 in 2016 includes a major rebalancing of spending priorities towards fragile states, with an array of new tools and instruments developed to facilitate this shift. The International Monetary Fund's (IMF) 2015 review enacted a range of adaptations in the context of the AAAA Addis Agenda, for example by increasing concessional funds available to the poorest and most at-risk countries eligible for the Poverty Reduction Growth Trust (PRGT) by 50%. Funding available through the IMF's Rapid Credit Facility (RCF, accessible to PRGT-eligible countries) and the Rapid Financing Instrument (RFI, accessible to all other countries) was also increased by 50% to provide increased responsive support to countries affected by fragility and shocks. The African Development Bank's (AfD) internal review of its engagement in fragile situations (2007-13) led to new policy decisions to provide integrated programmes of support using all Bank instruments, and made USD 2.2 billion in additional resources available between 2008-16, with a further USD 711 million under ADF14 (2017-19).

- **Exogenous pressures and shocks:** Several recent global crises have had a major influence in driving forward policy change and stimulating innovation to develop new instruments and approaches. The regional refugee crisis in the Middle East and the wider global migration situation were major stimuli to global-level policy debate in 2016, particularly among EU member states. A number of new instruments have been developed as a direct consequence. The Ebola virus outbreak in West Africa in 2015 also elevated long-standing challenges in global responsiveness to major health crises to the highest political levels and prompted institutional reforms, further strengthening the policy consensus in favour of ex ante financing solutions and leading to the creation of a new global instrument.

- **Political pressures:** For bilateral donors, domestic political influences and considerations have had a significant influence over policy and spending priorities; at times competing with the policy commitments prioritised by aid ministries and institutions. This has been borne out in a number of INCAF member countries, where recent changes in political administrations have led to significant policy shifts and in some cases cuts or expected cuts to aid budgets. In addition, in some European countries, the absorption costs of newly arrived refugees have been funded at the expense of other aid spending. This has been coupled with domestic political pressure to manage global migration flows as well as security and other potential or perceived risks, resulting in increased spending in fragile, conflict-affected and at-risk states, as well as a shift in programming emphasis, notably towards addressing the root causes of migration and violent extremism. The influence of political agendas is particularly felt in election years.

Sources: IMF (2015); GPPI, (2017); INCAF member interviews.

Globally there has been a conceptual shift “from funding to financing”

The ways in which peacebuilding, development and humanitarian actors understand the purpose, properties and potential of development financing flows is undergoing a conceptual shift. This shift is popularly described as a shift from “funding to financing” and this short-hand includes a number of ideas which re-cast the role and function of development finance. Funding is typically understood as a one-way transfer of resources for a specific time-bound project, programme or function. Financing, in contrast, is not necessarily a one-directional flow of resources, and concessional resources are considered a strategic asset which can be used to enable and catalyse other investments and which can take advantage of government-backed budgets, balance-sheets and robust credit ratings, to negotiate favourable rates, partnerships and products to extend financing into higher-risk environments, sectors and markets. A far wider range of financing types and tools may be deployed, including loans, bonds, guarantees, and insurance. And financing is tailored with greater precision to the particular investment needs and financial capabilities of the context. In particular, the most concessional types of financing should be reserved for situations where it can add the greatest value, targeting critical needs and gaps unlikely to attract financing from elsewhere.

This expanded concept of financing also increasingly considers concessional resources and the influence of donors and financing institutions as strategic tools which can be used to create incentives to promote desirable behaviours and prioritisation of investments, including creating the enabling conditions and incentives by which financing can be mobilised from other public and private sources.

In this new financing paradigm, development finance can be used strategically to:

- Catalyse investment from other public and private sources by offsetting investment costs and/or reducing risk;
- Incentivise desirable behaviours (such as appropriate management of risk; prioritising governance, economic and public policy reforms; alignment with national priority investment areas; co-ordination; inclusion; and transparency);
- Underwrite public goods at the country, regional and global-level, which might otherwise struggle to attract investment (and which in turn may enable peace, stability, economic development, and environmental protection);
- Actively mitigate risk by reducing the impact of financial and economic shocks and stabilising deteriorating governance and security situations; and
- Provide safety-nets for the most vulnerable and those exposed to shocks.

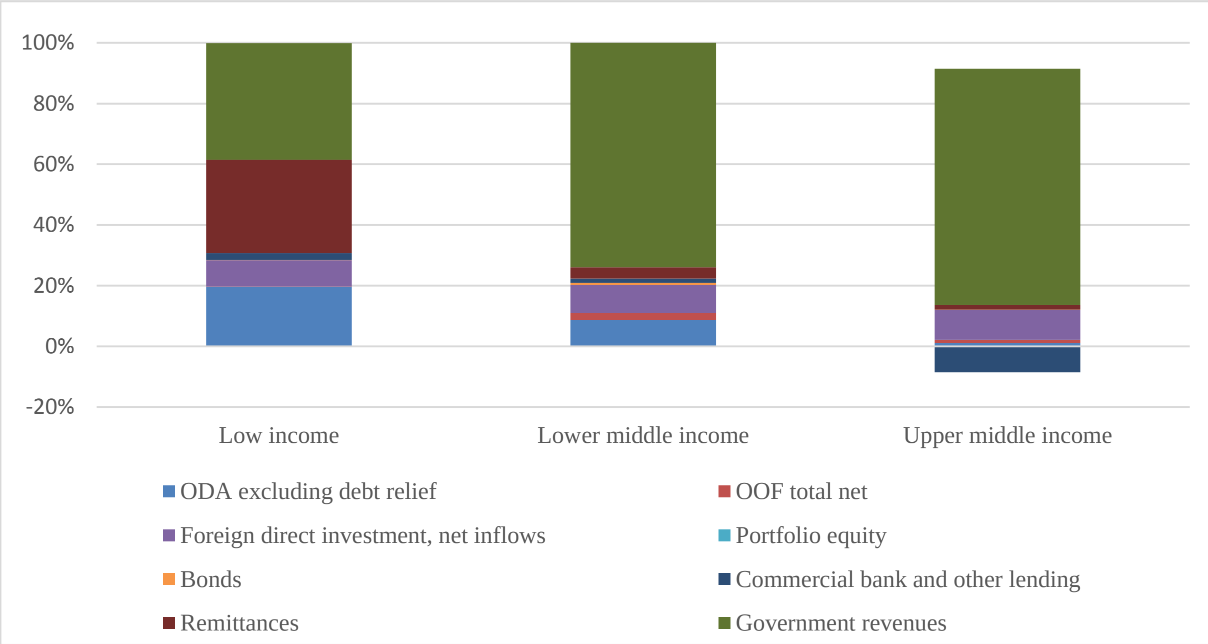
This conceptual shift is driving innovation in financing instruments, tools and approaches among development financing actors.

However, ODA (aid) remains a critical source of finance for fragile contexts

Development financing flows to at-risk, crisis-affected and fragile states are a critical resource with unique comparative advantages. ODA is already strongly concentrated in fragile and at-risk contexts. In 2015, USD 70 billion, which is 42% of total net ODA, and 65% of the total ODA allocated to the country-level, was allocated to the 56 states identified by the OECD as at risk of significant violence and fragility. Of this, 68% was allocated to low-income and lower-middle income countries. Concessional financing therefore constitutes a very significant resource for meeting critical financing gaps in low resource contexts and often represents a major source of external financing for peacebuilding, sustainable development, resilience-building and crisis response. In addition, in some fragile situations ODA represents a large proportion of Gross National Income (GNI): ODA represented 15% or more of GNI between 2011 and 2014, on average, in Rwanda, Haiti, the Central African Republic (CAR), West Bank and Gaza Strip, Burundi, Malawi, Afghanistan, the Solomon Islands and Liberia (OECD, 2016). In low-income contexts in particular, the relative importance of ODA in relation to other financing flows may be particularly significant (Figure 2.1).

Currently, the primary instrument in fragile contexts remains ODA grants. In 2015, 80% of ODA to fragile contexts was provided as ODA grants, and while innovation in the structure and function of ODA grant instruments is underway (Annex A outlines common concessional financing tools and instruments), the use of loans, and Other Official Flows (OOFs), including guarantees and export credits, remains much more limited. The following discussion outlines some of the notable areas of progress in adapting tools and instruments to the particular challenges of fragile and at-risk contexts in light of the broader global policy shift from funding to financing, and in context global policy commitments, including the SDGs.

Figure 2.1. Major financing flows in contexts affected by fragility and violence



Source: OECD DAC statistics; World Bank remittances data; IMF World Economic Outlook; UN DESA population estimates. Countries designated as affected by fragility and violence in the OECD's 2016 classification. Note that values are converted to a per-capita ratio for comparative purposes.

Growing interest in 'blended finance' for catalysing private investment

The use of development financing to leverage other investments has received considerable global policy attention, and is becoming a growing field of technical action. The AAAA identifies a key role for the private sector as a delivery partner and source of financing for sustainable development, and notes that development financing actors have a comparative advantage in offsetting otherwise prohibitive costs and risks for private sector investment in higher-risk markets and sectors. Approaches and financing tools to "crowd-in" private sector investment, as well as efforts to catalyse private sector investment and job creation through strategic investments and technical support to strengthen regulatory environments, macroeconomic policies and institutions, have become areas of keen policy interest and innovation, particularly with respect to mobilising financing for infrastructure investment and climate change mitigation.[4] [5] Notably, a major scaling up of investment in sustainable infrastructure will be fundamental to reaching commitments made at the 2015 Paris Conference of the Parties (COP) 21 global climate change agreement.

The potential for blended finance instruments to mobilise additional private sector financing has received a great deal of policy interest and attention and is driving innovation in instruments and approaches (Box 2.2). A 2015 OECD survey indicated that official development finance had been used to mobilise USD 36.4 billion from the private sector between 2012 and 2014 through guarantees, syndicated loans and shares in collective investment vehicles (CIVs), with a 44% increase in volumes mobilised across the period. Guarantees accounted for 59% of the total mobilised (Benn et al., 2016). Despite this growth, the use of blended finance remains rather limited overall in practice and is strongly concentrated among a few dominant actors. The OECD’s recent survey of 30 blended finance providers found that the six leading providers were responsible for 80% of funds mobilised and blended finance represents less than 1% of external financing flows to developing countries (Development Initiatives, 2016).

Despite limited use of blended finance to date, this is a growing field of action. New global instruments have been established and continue to evolve (Box 2.3) and a number of bilateral donors have indicated interest and commitment to developing their skills and capabilities in this area. Notably, the World Bank Group is looking to significantly increase its capacity to mobilise private sector investment through the new IFC-MIGA Private Sector Window, which leverages IDA’s balance sheet and the technical expertise and experience of IFC and the Multilateral Investment Guarantee Agency (MIGA) to overcome risk and financing constraints that would otherwise limit their scope to expand into higher-risk markets. Meanwhile, the EU announced a new European External Investment Plan (EEIP) in September 2016, which consolidates its existing blending instruments into two platforms under a new, global-level facility.

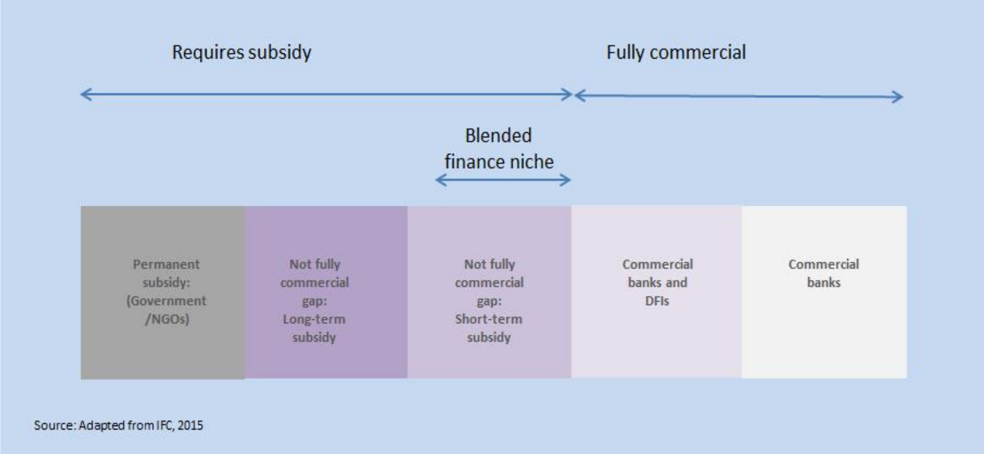
Box 2.2. Blended finance: Key terms and definitions

The OECD defines blended finance as: “the strategic use of development finance for the mobilisation of additional commercial finance towards the SDGs in developing countries”, where ‘development finance’ comprises both Official Development Finance,[6] as well as private funds that are governed by a development mandate, and where ‘commercial finance’ refers to both public and private sources of finance that do not have a 'development' mandate e.g. investment by public or privately owned pension funds or insurance companies, banks, businesses etc. (OECD, forthcoming).

It has the following three characteristics:

- Leverage – use of development finance and philanthropic funds to attract private capital.
- Impact – investments that drive social, environmental and economic progress.
- Returns – returns for private investors in line with market expectations based on perceived risk.

Blended finance may be used to enable investments with social and developmental impacts that might not otherwise happen because are not currently considered commercially viable, in terms of costs or risks. Blended finance may also be used to promote early investment in new industries and technologies that have the potential to deliver significant returns and to reduce investment costs in future. The International Finance Corporation (IFC) identifies the specific niche that blended finance targets as being on the margins of commercial viability, where some public subsidy may be required for a short period before long-term commercial sustainability can be realised.[7]



Different development financing institutions define blended finance in different ways, but with the common theme of combining concessional financing with market rate financing tools and instruments. Typically, instruments include loans, risk-sharing products such as guarantees, equity and grants. Grants and technical assistance are commonly provided as part of a package of support, including grants to support the development of fundable projects and financing packages, though these are not strictly speaking “blended” with other sources of finance, and in the case of technical assistance a transfer of funds may not take place.

Source: Benn et al. (2016); IFC (2015); WEF (2015).

Box 2.3. Global-level blending instruments

IFC, the private sector arm of the World Bank Group, targets investment in private sector-led projects. It typically lends on commercial terms, but has developed expertise in blended finance to incentivise investments in higher-risk markets and sectors with significant development impacts. IFC established a separate blended finance unit in 2008, supporting four thematic units and programmes: the Blended Climate Finance unit, the Global Agriculture and Food Security Program (GAFSP), the Global SME Finance Facility and the IFC-Goldman Sachs Women Entrepreneurs Opportunity Facility. Since 2009, IFC has blended a total of USD 385 million in concessional investments across 67 projects, leveraging over USD 4 billion in additional financing from third parties (both public and private).

The **IFC-MIGA Private Sector Window** (PSW) was created under the IDA18 replenishment as a means to expand private investment in the poorest countries, particularly those affected by fragility. The PSW combines the products and expertise of IFC and MIGA with the concessional financing resources of IDA, under four windows, the:

- Risk Mitigation Facility providing project-based guarantees without sovereign indemnity to crowd-in private investment in large infrastructure projects;
- MIGA Guarantee Facility expanding coverage of MIGA guarantees through shared first-loss and risk participation via reinsurance;
- Local Currency Facility providing long-term local currency investments in countries where capital markets are not developed and market solutions are not sufficiently available;
- Blended Finance Facility blending PSW support with IFC investments to support small and medium-sized enterprises (SMEs), agribusiness and other pioneering investments.

A new **European Fund for Sustainable Development** (EFSD) is central to the EU's 2016 European External Investment Plan. The fund is expected to mobilise investments of EUR 44 billion, using an initial contribution of EUR 3.35 billion from the EU budget and the European Development Fund (EDF). EU member states are encouraged to match contributions, including through second-loss guarantees, which could significantly increase the total funds mobilised. The EFSD will comprise two Regional Investment Platforms (Africa and the EU Neighbourhood), which bring together the EU's seven existing regional blending instruments to develop blended financing solutions. The EFSD will also provide partial guarantees to intermediary financing institutions, which in turn provide loans, guarantees and equity, with increased coverage against risk.

The **Africa Agriculture and Trade Investment Fund** (AATIF) is a public-private partnership (PPP) initiated by German development bank KfW and managed by Deutsche Bank, on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ), to promote investment in "climate-smart agriculture" in Africa. The fund is a PPP open to both public investors (including donor agencies, governments and International Financing Institutions (IFIs)) and private investors, who can invest at varying levels of risk. KfW and Deutsche Bank have agreed to absorb losses before the third tier (which comprises private investors only). The International Labour Organisation (ILO) and the UN Environment Programme (UNEP) act as compliance advisors to the fund, reviewing project compliance with its labour and environmental guidelines.

The **Private Infrastructure Development Group** (PIDG) was established in 2002 with the goal of helping to overcome obstacles to private sector involvement in infrastructure development in developing countries. The PIDG is also a PPP and comprises a group of donor organisations, including IFC; KfW; the Australian Department for Foreign Affairs and Trade; the UK Department for International Development; the Swiss Federal Department of Economic Affairs, Education and Research; the Dutch development financing bank FMO; the Dutch Ministry of Foreign Affairs; the Norwegian Ministry of Foreign Affairs; and the Swedish International Development Cooperation Agency. PIDG has established seven subsidiary companies, which provide tailored technical support and financing solutions (including loans and guarantees), all of which operate on a commercial basis. PIDG targets low-income and fragile states in sub-Saharan Africa and South and Southeast Asia. Between 2002 and 2015, PIDG reportedly mobilised USD 29 billion in additional investment from private sector investors and development financing institutions. It does not only target international sources of investment; for instance, PIDG subsidiary GuarantCo has formed a company with the Nigerian Sovereign Investment Authority to try to encourage investment by domestic pension funds in local infrastructure bonds by providing guarantees to infrastructure projects to reduce their risk profile, thus making them more attractive to investors.

Sources: AATIF (2016); IFC (2015); IDA (2016); Gregory and Sierra-Escalante (2016); PIDG.org.

But the risks associated with 'blended finance' need to be carefully managed in fragile contexts

Despite enthusiasm in policy circles, experience indicates that blended finance comes with a set of risks and limitations, particularly in fragile settings, which require caution, realism and careful management. The application of blended finance in fragile and crisis-affected contexts is limited by domestic constraints, and more comprehensive approaches to enabling private sector investment are required. Currently, blended finance is not strongly concentrated in the poorest or most challenging contexts and tends to target a limited range of sectors, notably the energy, industry, mining, construction and banking sectors (Development Initiatives, 2016). Blended finance may provide a partial solution to private sector investment challenges, offsetting risks and reducing the costs of investments, but it does not alter underlying market fundamentals and one of the most commonly cited barriers to private sector investment is a dearth of "bankable" projects (Jomo et al. 2016; UN, 2017a). Blended finance tools and vehicles alone cannot address the wider challenges of attracting private investment and some would argue that the potential for modest ODA investments to leverage private sector resources may be overstated (Jomo et al. 2016). In addition, there are a range of potential risks associated with incentivising private sector investment with concessional financing (Chapter 3), which include crowding out domestic investors, promoting inappropriate and financially unsustainable projects, and inadvertently exacerbating conflict risk and environmental degradation. Agreements on best practices to manage risks and modifications to adapt tools and approaches to situations fragility and risk currently lag behind the technical work of creating new instruments.

There is a strong case for focusing in the first instance on investing in the creation of enabling market conditions – including the legal, policy and regulatory environment - and in capacity-strengthening for project development.[8] Indeed, development financing actors are increasingly considering broader and longer-term investments to support the development of pipelines of investable projects and to strengthen the investment environment. The EU's EEIP, for instance, organises activities under three pillars: (1) mobilising private sector investments; (2) stepping up technical assistance to develop fundable projects, increasing the supply of investment opportunities; and (3) improving the business environment and engaging with the private sector (EU, 2016). Similarly, noting low uptake of risk mitigating financing instruments, such as its Partial Risk Guarantee and Partial Credit Guarantee in fragile settings, in addition to creating the Private Sector Credit Enhancement Facility created under ADF-13 (2013-2016)[9], under ADF 14 the AfDB committed to complementary capacity-strengthening support targeting the wider investment environment. This includes support to national investment promotion agencies and reforms to improve the business environment under Pillar III of its Transition Support Facility, which focusses on capacity strengthen needs and technical assistance, which does not fall within the scope of traditional projects and instruments (AfDB, 2014).

Enabling domestic private sector-led development is a growing field of action, yet it often falls between the cracks, with donor funding and policy timeframes often too short to deliver change, and little evidence on 'what works' in fragile settings. The private sector is not only a source of potential financing for development, but investing in private sector-led development is an important means by which to drive macro-economic growth, job creation and public sector revenue (tax) generation. Capital constraints for example, legislation and enforcement of contracts, are often significant limiting factors in fragile settings, and development finance is increasingly recognised as playing an important role in reform of the business environment.[10] However, planning, prioritisation and co-ordination structures reflect historic low levels of investment in the private sector, and are not yet well adapted to ensure adequate analysis of private sector constraints and priorities. In Myanmar for example, several donors are engaged in supporting private sector development including through for example strengthening the financial sector, technical and vocational training and support to small and medium-size enterprises, yet within the formal co-ordination architecture, there is no working group for the private or financial sectors. There are further challenging dimensions however. For example, there is limited guidance concerning the sequencing of investments and what types of investments and approaches have a meaningful impact in strengthening the business environment in fragile settings (Glanville et al. 2016). Additionally, investing in the enabling conditions for private sector growth often requires a relatively long-term return period, and sustained support. Financing tools and the scope of donor of planning and policy cycles however, often do not match the timeframes necessary to deliver change.

New instruments for managing risks and shocks are also emerging

A global conceptual shift towards ex ante management of risk has led to the emergence of a diverse ecosystem of instruments to manage and respond to risk. Risk financing was recognised as a priority in the Hyogo Framework for Action 2005-2015 and was identified as a priority of Mexico's presidency of the G20 in 2012. The Sendai Framework on Disaster Risk Reduction later reaffirmed the importance of financial protection against risk. In parallel with these high-level political dialogues and commitments, progress in developing financial tools and approaches to managing risk at the sovereign and regional levels has been under way for over a decade, and demand for these products among governments of countries and regions at risk of shocks continues to gather momentum (OECD, 2014). Multilateral development banks (MDBs) and some bilateral donors, including the Agence Française de Développement (AFD) and the Japan International Cooperation Agency (JICA), have modified existing loan products and developed new ones to give governments rapid access to finance in the aftermath of large-scale natural disasters, financial and economic shocks, without contributing to sharp increases in their debt burdens (Box 2.4).

Box 2.4. Loan products calibrated to help withstand shocks

Contingent credit lines: These are pre-negotiated credit arrangements that can provide governments with rapid access to funding at preferential rates in the event of crises, including natural disasters and economic shocks. They are typically available to existing loan customers, and eligibility may be contingent on demonstrating that effective disaster risk management planning and measures are in place. Examples include JICA's Stand-by Emergency Credit for Urgent Recovery (SECURE); IDA's Immediate Response Mechanism and Crisis Response Window; and the Inter-American Development Bank (IDB)'s Contingent Credit Line.

Counter-cyclical loans (CCLs): The terms of a CCL include ex ante agreements that debt repayments will automatically be reduced or in some cases temporarily drop to zero in the event of external shocks. This helps to reduce the need to take on new loans or to undertake time-consuming restructuring of existing debts in the aftermath of a crisis. The French Development Agency (AFD) first used CCLs in 2007 and has since employed them in Burkina Faso, Madagascar, Mali, Mozambique, Tanzania and Senegal for a range of development loans with a total value of USD 340 million.

Debt relief instruments: Creditors have the option of restructuring or cancelling outstanding debts in order to free up fiscal space and reduce the overall debt burden of crisis-affected countries. Debt relief is often a relatively lengthy process, however. The IMF modified its existing Post-Catastrophe Debt Relief Trust (PCDR) into the new Catastrophe Containment and Relief (CCR) Trust in 2015. The CCR issues grants for the service or repayment of loans in the event of a range of disasters, including public health emergencies, and is accessible to low-income countries and vulnerable small states which are already enrolled in IMF programmes. The earlier PCDR provided USD 268 million in grant financing to Haiti, entirely eliminating the country's outstanding debt to the IMF after the earthquake, and in 2015 the CCR provided USD 100 million in financing to Ebola-affected Guinea, Liberia and Sierra Leone.

Sources: OECD (2014); UNDP and AFD (2016); www.imf.org.

The technical services of multilateral development banks are in particularly high demand and the rapid growth in the market for disaster risk insurance instruments has also been a significant recent success story for MDBs, most notably the World Bank (Box 2.5).

Box 2.5. Risk transfer instruments

Parametric insurance: The advent of parametric indices has reduced costs and enabled the development of new markets for risk insurance products. Traditional indemnity insurance relies on costly verification of actual losses, whereas parametric insurance allows pre-defined payments to be triggered automatically when pre-agreed risk thresholds are breached. Dispensing with the need for verification creates substantial savings for the insurer. These savings are reflected in reduced premium costs, making parametric insurance a more affordable product for low-income purchasers.

Sovereign risk financing: MDBs have strong comparative advantages in advancing sovereign risk financing, having long-term partnerships with their lending partners and established relationships with key influencing and decision-making elements of government, notably ministries of finance. Their programming typically spans multiple sectors, so they are well positioned to support the integration of risk management. MDBs are able to act as intermediaries for their clients in negotiating access to reinsurance and financial markets. The Asian Development Bank (ADB), the Inter-American Development Bank (IDB) and the World Bank are either in the process of substantially expanding their service offerings in risk financing and insurance or have done so already. Notably, the World Bank's Disaster Risk Financing and Insurance Program (DRFI) has played a major role in recent years both in supporting technical development and negotiation with private sector actors to devise risk transfer instruments and in providing technical support for governments and private sector actors to anticipate, manage and make a range of financial provisions against risk.

Catastrophe bonds are a method of transferring insurance risk to capital markets. Insurance and reinsurance companies, governments and corporations sell bonds on the private capital markets and investors receive an attractive return on their investment, typically over a 3-4-year period, on the understanding that, in the event of a pre-defined crisis, part or all of their investment will be transferred to the insurance company to meet the cost of disaster losses. Payments may be calibrated against parametric triggers. Examples include Mexico's MultiCat catastrophe bond programme.

Micro-insurance includes a range of insurance products specifically designed for low-income clients, which protect against risks such as accident, illness, death and natural disaster. Many micro-insurance products make use of parametric indices to bring down the cost of premiums and to enable rapid automatic pay-outs. Micro-insurance is often "bundled" with other products and services, including micro-credit, money transfer services or social safety nets. Examples include the R4 Rural Resilience programme, a layered risk management programme for rural farmers in Ethiopia and Senegal led by the World Food Programme (WFP) and Oxfam America. The R4 approach includes a combination of risk management strategies, including improved resource management (risk reduction), insurance (risk transfer), micro-credit and livelihoods diversification (prudent risk taking) and savings (risk reserves).

Source: OECD (2014); www.worldbank.org.

Post-Ebola, there is now a growing appetite at the global policy level for more predictable, timely and efficient financing responses to global and regional crises. The widely-criticised response to the Ebola virus outbreak in 2014-16 exposed to a global audience the inadequacy of an international response built on ex post fundraising efforts. In response, emerging initiatives and instruments include regional risk financing pools and the global Pandemic Emergency Financing facility (Box 2.6).

In addition, a range of humanitarian actors, including the Red Cross/Red Crescent Movement, World Food Programme (WFP) and the international non-governmental organisation (NGO)-led START Fund are testing and preparing to scale up forecast-based financing mechanisms, which release funds for early action on the basis of pre-agreed triggers. However, the majority of international global crisis-response funding remains mobilised on an unpredictable ex post basis, and the fundamental structural challenge of ensuring adequate levels of contingency financing to respond in the early stages of predictable shocks has yet to be seriously considered by the international humanitarian system.

Box 2.6. Regional and global contingent and risk financing mechanisms

Sovereign risk pools: These financing facilities pool resources to spread risk and negotiate preferential insurance and reinsurance rates. The pool may retain part of the funds derived from subscriptions or may progressively accumulate reserves; they generally transfer higher levels of risk to reinsurance and financial markets at more favourable rates than individual states could otherwise achieve. Several regional risk pools protecting against natural disaster risks and using parametric triggers have been established since 2007. Examples include the Caribbean Catastrophe Risk Insurance Facility (CCRIF); the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI); and the African Risk Capacity (ARC).

Pandemic Emergency Financing facility (PEF): In the wake of the 2014-16 Ebola virus outbreak in West Africa, the World Bank and the WHO collaborated to develop a new financial tool to provide access to finance for the poorest countries in the event of future disease epidemics. The PEF includes insurance and cash windows. Participating partner countries have access to the insurance window, which can provide cover of up to USD 500 million for three years, with premiums funded by donors and the proceeds of catastrophe bonds, issued by IBRD. This window covers a set of known epidemic risk diseases including new Orthomyxoviruses (new influenza pandemic virus A, B and C), Coronaviridae (SARS, MERS), Filoviridae (Ebola, Marburg) and other zoonotic diseases (Crimean-Congo haemorrhagic fever, Rift Valley fever, Lassa fever). The replenishable cash window, which is expected to be in the region of USD 50-100 million, provides access to funds for emerging pathogens not covered by the insurance window, and also provides a route for donors to channel funds rapidly through established channels in the event of crisis.

The PEF is designed to complement existing financing instruments, including WHO’s Contingency Fund for Emergencies, and funds are accessible to governments and international agencies, including accredited UN agencies, the International Federation of Red Cross and Red Crescent Societies (IFRC) and Médecins Sans Frontières (MSF).

Source: www.worldbank.org

Flexible financing will be critical for delivering results across the humanitarian-development-peacebuilding nexus

The long-standing policy demand for flexible financing in situations of fragility, crisis and risk is beginning to deliver a new generation of instruments and

flexible approaches. Bridging the humanitarian-development-peacebuilding nexus (the nexus) is a key global policy priority, noted for example in the Agenda for Humanity's New Way of Working, which identifies the need to work towards achieving "financing modalities to support collective outcomes". Bridging the nexus is also noted as a key commitment area under the Grand Bargain. Humanitarian actors often find themselves unable to handover or transition to other sources of financing in many of the most fragile and crisis-affected contexts however, as there is often simply a dearth of flexible, risk tolerant development financing (Mowjee, Poole & Garrasi, 2016; Poole, 2017). However, new instruments are emerging (Boxes 2.7 and 2.8) which will help to address this gap – in the case of Germany's Transitional Development Assistance (TDA) instrument, substantial volumes of funds have been allocated. Other donors are developing new instruments and approaches. Belgium for example recently created a new Transitional Development and Governance Unit, which will manage funds for programmes addressing structural causes of fragility and building resilience.

Box 2.7. JICA's flexible partnerships with governments

The Japan International Cooperation Agency (JICA) has several characteristic ways of working, which enable it to work in close cooperation with governments, at a very practical technical level. Firstly, JICA partners closely with recipient country governments – all requests for funding must be initiated from the partner country government, and JICA has a strong commitment to using government systems whenever possible.

Secondly, JICA is both a donor and an implementer and works closely with partner governments on technical cooperation, including carrying out procurement of goods and services and monitoring and evaluating programmes directly.

Source: Donor interviews.

Donors are also building greater flexibility into their existing repertoire of instruments and partnerships. Multilateral development banks, notably the World Bank and AfDB, have revised their rules and established agreements to allow them to channel funds to UN agencies, enabling them to respond rapidly and flexibly where they might have no established presence. In 2017, for example, the World Bank announced funding packages of USD 200 million for WHO and UNICEF health sector support programmes to combat cholera in Yemen.[11] Canada has built crisis modifiers into a range of development financing agreements, which permit a pre-agreed proportion of funds to be reallocated to mitigation and early response in event of crises, without having to undergo a grant modification. "Pivoting" development financing into humanitarian programmes at moments of acute crisis is also becoming more common practice – USAID, Canada and Sida (Sweden) all managed to shift development funding into humanitarian programmes in the El Nino drought response in Ethiopia in 2016 for example (FAO, 2017). The International Committee of the Red Cross (ICRC) has recently launched an experimental Humanitarian Impact Bond to attract new funds from social investors to provide up-front liquidity, predictability, and incentivise delivery of improved results.[12] Meanwhile, humanitarian donors have committed under the Grand Bargain to provide an increased share of their funding in the form of multi-year agreements and currently this is one of the commitment areas with the most significant progress (GPPI, 2017).

Donors are also increasingly announcing multi-year combined humanitarian-development funding packages for crisis-affected situations (FAO, 2017).[13] Donor and recipient experiences of multi-year humanitarian financing agreements note the need to build into agreements both predictability – particularly in assuring stable partnerships and clear indications of financial commitment – and the flexibility to adapt programming responses to respond to changing priorities, risks and opportunities (ibid.). Balancing predictability and flexibility requires careful management however and requires, investments in partnerships and institutional capabilities to manage risk, and to analyse, learn and respond to change. In addition, donors must also manage trade-offs in flexibility at the global portfolio-level, when committing a greater share of their funds to longer-term agreements (ibid.).

The structural challenge of providing access to concessional financing during critical moments for middle-income status countries has yet to be resolved. Current development financing rules and practices have yet to adapt to the financing needs of upper-middle income countries exposed to significant risk, who currently struggle to access concessional financing to mitigate risk and respond to crises. The AAAA recognises this challenge, encouraging shareholders in multilateral development banks to adapt their graduation policies accordingly, noting the World Bank’s small island state exception (UN, 2015b). Similarly, the 2017 UN report for the Economic and Social Council forum on Financing for Development recommends a focus on ensuring sequenced and phased graduation policies, and new measures of progress that go beyond per capita income (UN, 2017b), so far however, concrete proposals have yet to be considered and adopted.[14]

Box 2.8. Germany's Transitional Development Assistance and Special Initiatives

The German Federal Ministry for Economic Cooperation and Development (BMZ) established an instrument to enable flexible financing in transitional situations in the early 2000s with the intention of providing a bridge meeting immediate humanitarian needs and investing in longer-term development cooperation.

In 2011, an inter-ministerial agreement between the Federal Foreign Office (FFO) and BMZ established a new division of responsibilities between the two ministries with a clearer delineation of responsibility for the Federal Foreign Office over humanitarian response. Transitional development assistance (TDA) therefore also serves as an important tool in linking and synchronising humanitarian and longer-term economic development efforts across the two ministries and ensuring consideration of transitional issues across both portfolios. Funds channelled through the TDA have increased from EUR 190 million in 2014, rising to a peak of EUR 940 million in 2016, with an anticipated spend of EUR 875 million in 2017.

BMZ's 2013 strategy identifies the primary aim of transitional development assistance as to "increase the resilience of people and institutions to withstand the impact and consequences of crises, violent conflict and extreme natural events, while improving the prospects for sustainable development." BMZ's transitional development assistance is typically provided in situations of fragility and protracted crisis; in high-risk countries exposed to natural hazards and climate change; and in recovery situations. Transitional development assistance focusses on activities including reconstruction and rehabilitation of basic social and productive infrastructure; disaster risk management; reintegration of refugees; and food and nutrition security.

From 2014, BMZ also launched a number of Special Initiatives on Crisis and Fragility, developed to address emerging challenges including:

- ***Tackling the root causes of displacement, reintegrating refugees*** This initiative, provides both short-term support to refugees and host communities, as well as investing in addressing the long-term structural causes of displacement including poverty, inequality and lack of food security. This initiative received EUR 170 million in 2014, EUR 160 million in 2015, growing to EUR 406 million in 2016 and is expected to further increase in 2017.
- ***Stability and development in the MENA region*** This initiative seeks to respond to support political transition in the region through investing in peacebuilding, and in activities that will foster economic stability (including training and job creation) and democracy.
- ***One World – No Hunger*** This special initiative takes a longer-term approach to addressing the causes of hunger and malnutrition, including job creation and income generation, giving people fair access to land and protecting natural resources.

Sources: BMZ (2013); BMZ and FFO (2013).

The increased focus on country programmes has reduced the pool of financing for global and regional public goods

In an increasingly connected world, risks and their impacts are transboundary. Climate change, epidemics, security risks and financial crises in particular require collective action (Birdsall and Diofasi, 2015). The multilateral system plays a key role in providing governance frameworks, norms and policy, mobilising financing, and responses to global challenges. Notable examples of multilateral global public goods mechanisms include UN peacekeeping and the IMF's global surveillance of financial and economic risk (ibid). However, the international community faces many challenges in adapting to rapidly evolving risks including reaching new settlements, agreements and developing new tools. As noted above, recent crises have highlighted structural weaknesses in existing tools, which in some cases have led to new innovations, such as the Pandemic Emergency Facility (Box 2.6) created in the wake of the Ebola virus outbreak. Many challenges remain however in providing coherent, effectively targeted and adequately resourced financing solutions for global public goods. Meeting the cost of hosting refugees and of sustaining peace, provide key illustrations of some of the current technical, political and resource mobilisation challenges in meeting the costs of delivering global public goods.

One exception is the financing of refugee responses

There is notable progress in international responses to supporting refugees. A new set of global commitments, expected to provide the framework for a more "comprehensive and people-centred refugee response" is under development in the Global Compact on Refugees, which is supported by the already operational Comprehensive Refugee Response Framework (CRRF) (UNHCR, 2017). New funds have been made available - under the IDA18 replenishment, the World Bank has created a USD2 billion facility providing grants and concessional loans for projects benefitting refugees and host communities, which represents significant additional funds. New tools have been created, such as the EU Emergency Trust Fund for Africa (see Box 2.9) and the Global Concessional Financing Facility (GCFF), an innovative approach to leveraging additional funds a creative work-around to the challenge of providing concessional financing to upper middle-income states (Box 2.10). Challenges remain however in providing a predictable response to the global public good of providing refuge. It is notable for instance, that the funding response to the first CRRF to be rolled out, in Uganda, has fallen well short of requirements in 2017.[15]

Box 2.9. The EU Emergency Trust Fund for Africa

The EU Emergency Trust fund for Africa was established at the Valletta Summit on Migration in November 2015, and is designed to "address the root causes of instability, forced displacement and irregular migration and to contribute to better migration management."

By late 2017, the trust fund had received EUR 2.9 billion – comprising EUR 2.7 billion from the European Development Fund and EUR 227.7 million in contributions from EU Member State and other partners.

The trust fund focusses much of its resources on job creation and economic development, including a focus on vocational training and support to micro and small enterprises. Other priorities include basic service provision, support to prevention of irregular migration, fighting human trafficking, and support to governance and stability. By September 2017, the trust fund had committed EUR 1.9 billion to 117 projects across the Sahel/Lake Chad (EUR 1 billion); the Horn of Africa (EUR 665 million), and North of Africa (EUR 264.7 million).

Source: EU, 2017

Box 2.10. Global Concessional Financing and Guarantee Facility

The regional refugee crisis in the Middle East and North Africa (MENA) has had experienced severe economic consequences for countries in the region, as a result of hosting huge numbers of refugees and the disruption to markets caused by regional insecurity. Meanwhile, the World Bank Group found itself in the difficult position of being unable to provide concessional finance to Jordan and Lebanon, which are both upper middle-income countries, and thereby ineligible for concessional finance under Bank rules despite obvious and considerable financing needs.[16]

In October 2015 the World Bank, the UN and the Islamic Development Bank launched a new financing initiative to mobilise funds and improve co-ordination among international organisations, designed to address the development impact of the refugee crisis on countries in the MENA region, with an initial focus on Lebanon and Jordan. In April 2016 Japan, France, the United Kingdom, the United States, Germany, Canada, the Netherlands, Norway and the European Commission pledged a package of more than USD 1.6 billion, comprising USD 141 million in grants, USD 1 billion in soft loans and USD 500 million in guarantees. The facility helps to overcome the MDB's challenge of providing concessional finance to upper-middle income countries by blending grants with loans to soften loan terms, as well as providing a package of guarantees to mobilise private sector investment.

The CFF became a Global Facility in September 2016. It plans to raise USD 1.5 billion in grants over the next five years to provide middle-income countries hosting large numbers of refugees with around USD 4.5-6 billion in concessional financing to support refugees and host communities in key sectors such as jobs, education, health and infrastructure.

Source: www.worldbank.org.

However, other key areas like peacebuilding and prevention still have significant financing challenges

Sustaining peace as a shared responsibility and fundamental precondition for sustainable development has received renewed policy emphasis since 2015, yet despite notable progress, many financing challenges are yet to be resolved. The

2015 Review of the United Nations Peacebuilding Architecture identified a range of criticisms of current approaches to peacebuilding, including that "peacebuilding is left as an afterthought: under-prioritised, under-resourced and undertaken only after the guns fall silent." (UN, 2015a). The review identifies the need for comprehensive approaches to sustaining peace,[17] which support inclusive national ownership and which place much greater emphasis on conflict prevention; the need to provide sustained support over realistic timelines; to focus on addressing root causes not just the cessation of hostilities; and the need for coherent approaches across the peace and security, human rights and development pillars of the UN. Of particular note, the UN Peacebuilding review identifies inadequate financing for sustaining peace as a key failing: "the present failure to prioritise and resource efforts towards sustaining peace is condemning the world and its peoples to tragic, violent cycles of relapse." Increased levels of predictable financing therefore are identified as a key priority.

Country-level pooled funding instruments supporting peacebuilding could support mobilise funds and improve co-ordination, transparency and targeting. Pooling of resources for sustaining peace across UN, World Bank and other bilateral and multilateral financing institutions is noted as a useful strategy to maximise impact and share risk (Scholz and Pietz, 2016); as a means to attract funding for 'transverse' elements of the SDGs, including prevention (UN, 2017a); and for helping to bridge siloes between humanitarian, development and peacebuilding actors and approaches (UN, 2016). In Myanmar for example, donors have created peacebuilding funds which have helped to reduce fragmentation, increase visibility and transparency of funding for peacebuilding (Box 2.11).

Box 2.11. Pooling resources for sustaining peace at the country-level in Myanmar

Supporting the peace process in Myanmar is widely recognised by international actors as a key priority and as fundamental to enabling sustainable development. Peacebuilding is therefore a priority within many donor portfolios. However, donor co-ordination in Myanmar is challenging, with foreign governments rushing to re-engage with Myanmar following its democratic transition, and a government facing a huge range of urgent challenges, with limited capacity. In a peacebuilding process where building trust among negotiating parties is critical, financing decisions take on elevated significance and must be co-ordinated with great sensitivity and transparency. Co-ordination and leadership are also extremely sensitive issues. Co-ordination of donor support to the peace process falls outside of the normal sector-based government-donor co-ordination forums and the perception of control by government of a process which is still under negotiation may lead to the perception of bias.

The UN Peacebuilding Fund (PBF) has provided USD 7.7 million in funding for the peace process since 2012, targeting a range of key peacebuilding support activities, including providing complementary funding to EU support to the establishment of the Myanmar Peace Centre that helped to facilitate dialogue between the military and ethnic armed groups.

Recognising the risks of proliferation of poorly co-ordinated funding support to peacebuilding, the Peace Support Fund was created by the UK Department for International Development (DFID) in early 2014 to co-ordinate donor support to the peace process and to supporting inter-communal harmony. The PSF receives funding from the UK, Australia and Sweden and has undertaken mapping exercises of donor support for peacebuilding and co-finances peacebuilding projects in a number of cases to further support co-ordination.

In 2015, a larger fund, the Joint Peace Fund (JPF) was established to co-ordinate donor support to the core elements of the peace process. The JPF receives contributions from ten donors: Australia, Canada, Denmark, the European Union, Finland, Italy, Norway, Switzerland, the United Kingdom, and the United States who have collectively pledged over USD 100 million to be disbursed up to 2021.

The PSF has been responsive to the changing funding environment and has shifted its emphasis since early 2015 towards civil society-led projects to support inter communal harmony and social cohesion, re-branding itself as the Paung Sie Facility to reflect that shift.

Source: Myanmar case study

Recognising the substantial potential returns on investments in sustaining peace, a new generation of shock- and opportunity-responsive financing instruments is emerging. The UN Peacebuilding Fund (PBF) has been the primary instrument within the UN peacebuilding architecture enabling a timely, flexible and risk-tolerant approach to financing peacebuilding. The PBF has continued to adapt and respond to new challenges including diversifying its partner base by establishing legal agreements enabling it to fund multilateral development banks and civil society actors; seeding funds to country-based multi-donor trust funds; and funding high-risk projects to build confidence and catalyse support from other donors. During the 2013 political and security crisis in the Central African Republic (CAR) for example, the PBF allocated USD 4.6 million within three days of request to pay the salaries of 3,417 police and gendarmerie officers for five months as part of a financing division of labour agreed with the UN and World Bank to meet the costs of critical civil service salary gaps during a critical moment of government instability. In addition, an increasing range of responsive and flexible financing tools and approaches are also emerging from outside the UN system, designed to help respond rapidly to deteriorating situations or sudden opportunities for political and economic reform, stabilisation or peacebuilding (Box 2.12). However, ensuring adequate flexible funding for sustaining peace in critical moments, including financing peacebuilding during the winding down and exit of peacekeeping missions, remains an ongoing challenge. Providing sustained financing support to peace processes and transitions also remains challenging in the contexts of short-term ODA planning and budgeting cycles. The necessary time-span for support however is likely to run into decades – for example EU financing support to the peace process in Northern Ireland includes three support packages spanning the period 1994 – 2020 at a cost of EUR 2 billion (World Bank and UN, 2017).

Box 2.12. Shock-responsive development and peacebuilding instruments

World Bank turnaround and risk mitigation regimes: The IDA Turnaround Facility enables significantly increased allocations at critical junctures in a country's development trajectory where opportunities for building stability and resilience exist. These may include a cessation of conflict, major changes in the policy environment or opportunities to resume World Bank lending relationships. For example, the World Bank approved a USD 250 million package of assistance over three years to CAR following democratic elections in March 2016, which marked the end of transitional political arrangements. The package is five times greater than would normally be the case under IDA's country allocation formula and includes a focus on key peace and state-building priorities, including public financial management, job creation and reintegration of former combatants and displaced people.

Under the IDA18 replenishment in 2016, the World Bank created a new approach to complement the turnaround regime, which enables countries to access significant additional funds to invest in projects that target the management of risk and strengthening of resilience. Countries engaging in risk and resilience assessments may be eligible to receive up to USD 300 million in additional financing.

EU State Building Contracts: In 2013 the European Union (EU) introduced State Building Contracts (SBCs) to provide tailored and flexible budget support to fragile and conflict-affected states; the contracts include a combination of regular and performance-related payments plus a package of technical assistance. SBCs have now been used by the EU in a range of contexts and scenarios, including classic institutional strengthening scenarios, such as two successive SBCs in Sierra Leone where the stated objective was to "support the Government of Sierra Leone in improving resilience to face external shocks and in reaching the New Deal Peacebuilding and Statebuilding Goal of 'improved management of revenue and increased capacity for accountable and fair service delivery'".

The EU has also used SBCs to provide targeted financial support at critical moments when the risk of not providing support to help stabilise political and fiscal crises is considered to outweigh other potential risks. In Mali, for example, an SBC played a key role in maintaining fiscal stability during a period of democratic transition, following the 2013 political crisis which had led to the suspension of a large proportion of bilateral donor financing. In Ukraine, following the impeachment of the president and the appointment of a new government in 2014, the EU issued a package of support measures, including an SBC, designed to help stabilise the economic and financial situation and support political and economic reforms.

AfDB Transition Support Facility (TSF): The TSF was designed to mobilise additional resources and provide fast and flexible financing to meet a range of constraints faced by governments and the private sector in situations of fragility and conflict. The facility is designed to help countries consolidate peace, build resilient institutions, stabilise their economies and lay the foundations for inclusive growth, and is organised around three pillars. Pillar 1 provides supplemental resources for national, regional and private sector operations to support countries in their state-building efforts; Pillar 2 supports arrears clearance to enable eligible countries to normalise relations with the international community and access debt relief; Pillar 3 provides support to capacity- building interventions and technical assistance outside the scope of traditional projects and instruments. In practical terms the TSF employs the AfDB's comparative advantages and instruments flexibly. For instance, the AfDB acts as fund manager for the Somalia

Infrastructure Fund under the TSF, lowering risks, providing financial safeguards, and lowering transaction costs for donors and investors. Since the Ebola outbreak, the TSF has increasingly been used to finance humanitarian-development-peacebuilding nexus projects including during the Ebola crisis, in the Lake Chad basin crisis and in upcoming projects centred on displacement, migration and refugee issues in fragile situations.

Norway Gap Funding: Norway has an unusual degree of flexibility and risk tolerance in funding channelled through its "Gap Funding" window. In 2013, at a critical moment in Somalia's political transition, Norway provided targeted financial support to the Federal Government of Somalia (FGS) to pay civil servant salaries and fund a range of projects that other donors were unable to finance. The Government of Norway and the FGS established a Special Financing Facility, which was operational within eight months and enabled the FGS to project its authority and ability to deliver at a sensitive moment in the political transition. The Special Financing Facility also served as a bridging mechanism to maintain the flow of funds for civil servant salaries until multi-donor trust funds became operational. Norway has also used this flexible financing to provide targeted support to the peace process in Colombia, where Norway has served as one of two international guarantors to the peace process since 2012.

Sources: AfDB, (2014); Bernardi et al. (2015); EU (2014); EU (2015); g7+ (2016); OECD (2016); www.worldbank.org.

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Notes

[1] "The key finding of the 2011 Survey is that most aid actors are neither set up to meet the specific challenges posed by fragile situations, nor systematically able to translate commitments made by their headquarters into country-level changes." (OECD DAC, 2011)

[2] The World Bank's seminal World Development Report 2011: Conflict, Security, and Development proved highly influential in establishing conflict and security as central developmental challenges, while highlighting the critical role of robust institutions and governance and noting the need for substantial changes in approach and in institutional behaviour (World Bank, 2011).

3 Support for the New Deal's five Peacebuilding and Statebuilding Goals (PSGs) and TRUST partnership principles remains firm at the highest policy levels, and indeed signatories reaffirmed their commitment to these goals and principles and committed to use the New Deal principles to achieve the SDGs in fragile and conflict-affected situations in the April 2016 Stockholm Declaration. Yet, as the Stockholm Declaration acknowledges, implementation of the commitments remains well behind expectations.

4 The AAAA (UN, 2015b) notes, for example, that: "Monterrey tasked us to build transparent, stable and predictable investment climates, with proper contract enforcement and respect for property rights, embedded in sound macroeconomic policies and institutions. Many countries have made great strides in this area. We will continue to promote and create enabling domestic and international conditions for inclusive and sustainable private sector investment, with transparent and stable rules and standards and free and fair competition, conducive to achieving national development policies. Internationally, we will support these efforts through financial and technical support and capacity-building and closer collaboration between home and host country agencies. We will consider the use of insurance, investment guarantees, including through the Multilateral Investment Guarantee Agency, and new financial instruments to incentivise foreign direct investment to developing countries, particularly least developed countries, landlocked developing countries, Small Island Developing States and countries in conflict and post conflict situations."

5 Indeed it could be argued that the climate resilience community has long recognised the need to attract investment from and to involve the private sector in the delivery of low-emission and climate-resilient development.

[6] Official Development Finance includes: (a) bilateral official development assistance (ODA), (b) grants and concessional and non-concessional development lending by multilateral financial institutions, and (c) Other Official Flows for development

[7] Gregory and Sierra-Escalante (2016) caution: "Blended finance can sometimes be helpful to tip the balance in marginally profitable, risky projects toward attracting commercial investment, but it cannot alter the fundamental economics of an industry."

8 Jomo et al. (2016) argue "the claim that modest donor involvement through blended finance can leverage large quantities of private investment amounts in developing countries seems questionable. How could incremental reductions in required returns (e.g., through small subsidies or guarantees) make a large number of projects commercially viable, when the private sector consistently points out that the real constraint on investment is the lack of bankable projects? Consequently, the potential for blended finance or leveraging private sector resources through ODA may be overstated. If this is the case, then capacity building for project development deserves greater attention from donors than blended finance."

9 As at end 2015, the AfDB reports that the Private Sector Credit Enhancement Facility had approximately UA 160 million of exposures allocated to 15 transactions of which more than 50% are in fragile situations. Examples of approved projects include an energy project in Sierra Leone that will increase by 50% the country's power generation and the construction and operation of a new transhipment container terminal in Togo is expected to create 670 new permanent jobs and currently has 2000 temporary jobs during construction phase.

10 The donor Committee for Enterprise Development (DCED, 2008) defines the business environment as a "complex of policy, legal, institutional, and regulatory conditions that govern business activities. It is a sub-set of the investment climate and includes the administration and enforcement mechanisms established to implement government policy, as well as the institutional arrangements that influence the way key actors operate (e.g. government agencies, regulatory authorities, and business membership organisations including businesswomen associations, civil society organisations, trade unions, etc.)." in Glanville et al. 2016.

11 http://www.worldbank.org/en/news/press-release/2017/08/28/world-bank-mobilises-us200-million-to-combat-cholera-in-yemen

12 See: https://www.icrc.org/en/document/worlds-first-humanitarian-impact-bond-launched-transform-financing-aid-conflict-hit

13 For example, Canada announced a three-year joint humanitarian and development financing package for the regional crisis in Syria and Iraq in 2016, and Norway has recently announced combined humanitarian and development financing pledges over a period of three years for Nigeria and the Lake Chad Basin. Sweden's five-year development strategy for the Syria regional crisis is designed to complement humanitarian funding through a series of targeted resilience-strengthening investments.

14 At their 2017 High Level Meeting, OECD DAC members agreed to "review and reflect on the evidence base that documents the consequences of different graduation processes on access to development finance from all sources, and will continue to conduct policy analysis on the patterns of co-operation, including financing, channels, and objectives in countries in transition, in co-ordination with other relevant actors. We note international discussions on new measures and metrics of development progress beyond per capita income." (OECD DAC, 2017).

15 At 10th November 2017, USD 349.3 million of a required USD 2 billion had been pledged or received. http://pulselabkampala.ug/pulselabkampala/pledge_sys/pledge_tracker/

16 Maintaining debt sustainability was also an important consideration, particularly in Lebanon.

17 The Peacebuilding Review describes this comprehensive approach to sustaining peace as extending "all along the arc leading from conflict prevention (on which, in particular, the UN system needs to place much greater emphasis), through peacemaking and peacekeeping, and on to post-conflict recovery and reconstruction. The success of such an approach critically relies on uniting the peace and security, human rights and development "pillars" of the UN." (UN, 2015a)

Chapter 3. Continuing challenges

The previous sections have outlined emerging approaches, tools and instruments which have the potential to make significant contributions to scaling-up and increasing the effectiveness of investments in crisis-affected, vulnerable and at-risk contexts. The following section outlines a range of risks, emerging and existing challenges that will require careful management.

Better finance will require investing in better context analysis, prioritisation and design

The public goods of shared analysis, prioritisation, strategic response and design are not well recognised or financially supported. Current approaches to engaging in fragile states, with a primary focus on political conflict and strengthening the capacity of institutions are out of touch with current realities (OECD, 2016a). In order to move beyond "entrenched patterns" that focus on structural causes and factors "requires deeper understanding of the complexity of violence, a willingness to embrace measured risk, and the courage to try new approaches." (ibid.).

The foundation of a robust and nuanced strategy in a fragile context is a deeply contextualised analysis of the problem. Despite global commitments to joint and better contextualised analysis,[1] this is a function in which development financing actors consistently under-invest. While many actors have adopted and internalised tools to enable conflict, political economy and power analyses into their programme design, these often remain tick-box exercises which often focus heavily on institutional capabilities, political dynamics and risks, and consideration of a wider-range of contextual risks is relatively uncommon, with disaster risk analysis typically treated as a separate technical field (OECD, 2016b). The AfDB's new Country Resilience and Fragility Assessment tool provides an example of emerging approaches to building in multi-dimensional and measurable analysis of risk and fragility to analysis, planning and design (Box 3.1)

Box 3.1. The AfDB's Country Resilience and Fragility Assessment tool

Under the AfDB's Strategy to Address Fragility and Build Resilience in Africa (2014-2019) AfDB institutionalised the qualitative assessment and management of fragility risks through the application of a fragility-lens approach, which it systematically applies to assess the political, security, economic, social and environmental risks and guide its strategic and operational engagement.

To further improve the quality and depth of assessments, the Bank will pilot a standardised assessment tool from 2017. The Country Resilience and Fragility Assessment (CRFA) measures pressures facing a country or region as well as capacities for response and resilience over 7 key dimensions. The CRFA will enable the Bank to track trends over time, and better identify entry points for country dialogue, programmatic engagement and intervention.

Source: AfDB Transitions States Support Office

Interestingly, projects and programmes typically invest more heavily in monitoring and ex-post evaluation rather than project design and operational learning. This is despite recognition that fragile, crisis-affected and at-risk contexts are often unpredictable, that vulnerability and risk typically are complex and multi-causal, and that change is non-linear. USAID Food for Peace's experimental Refine and Implement approach demonstrates emerging new thinking and practice on developing adaptive programming tools and approaches where investments in learning and context-driven design are a core element of the programme (Box 3.2).

Box 3.2 USAID Food for Peace's Refine and Implement approach.

In 2016 USAID Food for Peace (FFP) piloted a new programming approach in the Democratic Republic of Congo. The Refine and Implement approach emerged from extensive consultations with partners, and acknowledges that programme design too often takes place removed from operational realities, while considerable learning and adjustment often takes place 'on the job' as organisations begin to implement activities.

FFP encourages implementing partners to develop theories of change (ToCs) for all development food security activities. This helps strengthen the logic of strategies to address underlying causes of hunger and malnutrition. The addition of the Refine and Implement element allows partners to adjust these theories and assumptions to programming realities with a full year permitted to carry out formative research and community consultations.

At the end of year one, partners present the results of their learning, along with a revised theory of change, partnership plan and updated implementation schedule, for review and approval by FFP. Implementation is expected to begin from year two onwards through a possible five-year implementation period. In the fourth year, the programme undergoes an evaluation, on the basis of which the programme may be wound up in year five, or extended for a further three to five years.

FFP anticipates that the Refine and Implement approach will ultimately result in programmes which are more closely tailored to the operating environment, will allow innovation, iterative learning, and strengthening of partnerships and co-ordination with local stakeholders.

Source: Whelan (2016)

Financing strategies are useful tools to help meet country-level priorities

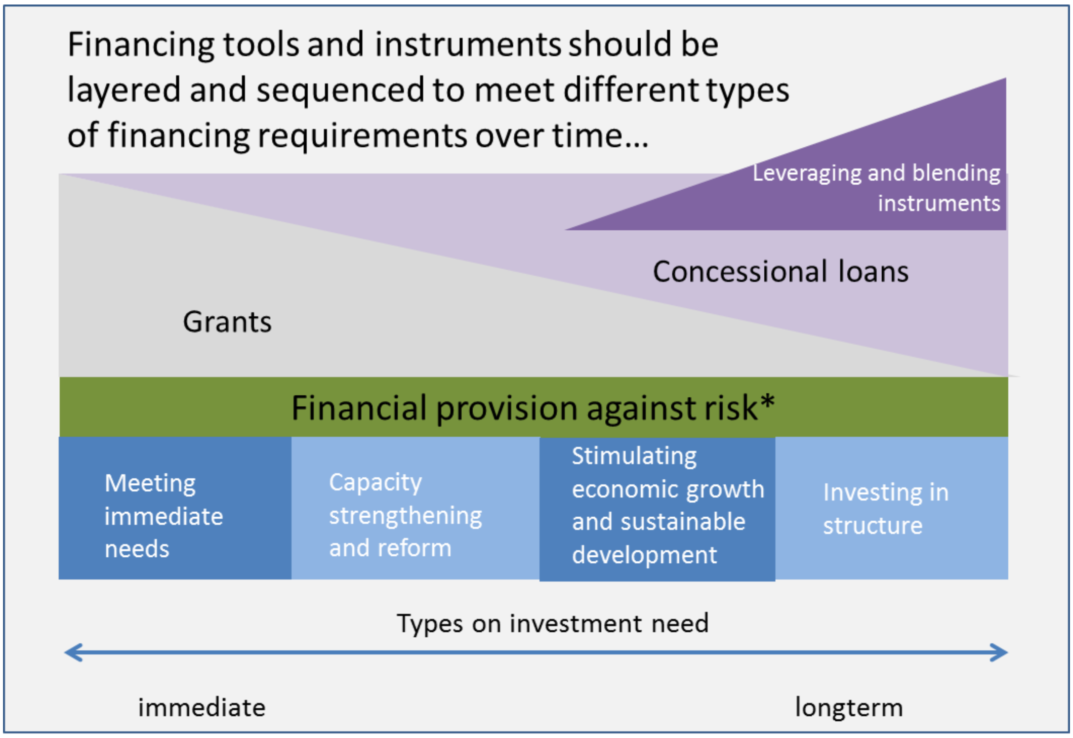
The idea of developing financing strategies to support the delivery of results for sustainable development has gained considerable traction among development actors and governments, notably with the inclusion of Integrated National Financing Frameworks (INFFs) in the AAAA, which are framed as an important tool by which countries are encouraged to link development finance with the 2030 Agenda for Sustainable Development.

A financing strategy is an opportunity to look beyond immediate financing gaps to consider the potential contribution of a range of financing actors and flows to strategic development, peacebuilding and resilience goals over a medium- to long-term timeframe. A robust analysis and explanation of critical enabling factors and risks can help to identify priority investments, help financing actors to understand how their investments contribute to the achievement of higher-level goals or results, and crucially, can help to ensure that financing tools, instruments and approaches are matched and tailored to the context analysis and priorities. A financing strategy can also help to:

- rationalise prioritisation and sequencing of investments (Figure 3.1);
- provide incentives, reforms and policies to strengthen public financial management;
- stimulate revenue generation, private sector investment and economic growth;

- identify and quantify contingent financing needs;
- identify specific actions to make financial provision against risk;
- build platforms for dialogue and inclusion of a far wider range of actors, in particular private sector actors, who can better articulate their constraints and priorities, helping to ensure that public policies and incentives are calibrated to target priority actions with the greatest returns; and
- develop a more holistic approach to managing potential risks and unforeseen consequences of investments – including environmental damage, market distortions, debt sustainability, exacerbating social or political instability – in an increasingly complex financing landscape.

Figure 3.1. Matching development finance instruments against types of financing need



Note: Financial provision against risk includes disaster risk financing tools such as contingent financing, insurance and risk transfer, as well as shock-responsive financing instruments.

Comprehensive country-level financing strategies are not yet a part of planning and prioritisation packages and will require a range of incentives and targeted investments to ensure their routine use in fragile, crisis-affected and at-risk contexts. Since financing strategies have not been a regular feature of planning and prioritisation processes, technical capabilities and in-house expertise are currently somewhat limited, especially in the field. The more widespread application of comprehensive financing strategies is likely to require targeted investment in skills and knowledge at the country-level as well as at higher-institutional levels, as well as ongoing investments in the development of tools and guidance.

Delivering the right finance will often mean changes to institutional structures and investments in increasing financial literacy and capacity

Scaling up and working effectively on finance in crisis-affected, fragile and at-risk contexts requires a range of investments in organisational technical capabilities, increased capacity at country and regional levels and increased capacity to work in collaborative partnerships.

Shifting towards an investment culture and practice requires both a conceptual shift and a variety of reforms, upgrades and investments in the financial tools, instruments and management capacities of international financing actors. Working more flexibly has implications for how organisations structure and manage their operations. Working effectively in higher-risk and unpredictable contexts requires the capacity for critical dialogue with partners as well as tools, procedures and a management culture that incentivises learning and tolerates altering course – all of which have implications for staffing levels and skills and the locus of decision-making authority (OECD, 2016a). While many institutions have signalled their commitment to work to address the challenges of fragility, crisis and risk, few have significantly increased their staffing capacities at country or regional level, altered their management approaches to enable flexible, risk-tolerant approaches at the country level or embedded institutional incentives to work collaboratively.

Expanding into financing partnerships with private sector investors requires a new range of partnerships and technical skills and tools. Blended finance requires a high degree of technical skill to develop what can be complex investment structures, and it requires working with a wide range of public and private actors, who each bring their own interests and priorities. In order to avoid costly investment mistakes, and sending false market signals, development financing actors will need to invest considerably in their analytical and technical capabilities to make informed business decisions, as well as investing in their ability to manage partnerships with a range of new actors (Gregory & Sierra-Escalante, 2016). Recognising challenges in the suitability of existing instruments to fragile and higher-risk contexts, the French government for example is undertaking research and analysis to inform adjustments and development of new financing tools and instruments (Box 3.3).

Similarly, financing for sustaining peace is inhibited by institutional disincentives. Donor experiences implementing the New Deal's five Peacebuilding and Statebuilding Goals (PSGs) – including PSG1 'legitimate and inclusive political settlements and conflict resolution', offer lessons the practical barriers and disincentives likely to be encountered in meeting commitments to SDG 16 'Promote just, peaceful and inclusive societies' (van Veen and Dudouet, 2017). In addition to operating with an "incomplete and inadequate understanding" of the fragmented and contested politics of fragile societies, and conceptually flawed programming tools, donors face a number of institutional constraints to their ability to work effectively on peacebuilding, including high staff turnover, risk aversion, poor local language skills, short-termism, inter-donor incoherence, and a lack of focus on learning and institutional incentives (ibid.). There may also be political mismatches between the stated aspirations of peacebuilding objectives and the political realities of donor government engagement, particularly in settings where they are actively involved in the conflict and where their security priorities are likely to prevail. Which of these institutional trade-offs and constraints can be managed and how requires serious consideration if donors are to make good on their commitments to investing in sustainable peace.

Box 3.3. AFD's investments in knowledge generation to drive adaptation of tools and instruments

France's Agence Française de Développement (AFD) is investing in knowledge generation to drive modifications of its existing financing tool-kits to provide effective financing solutions in the most challenging contexts.

AFD co-authored a study with UNDP in 2016 "Financing the SDGs in the Least Developed Countries (LDCs): Diversifying the Financing Tool-box and Managing Vulnerability", which considers the potential to apply a more diverse financing toolbox – including blended finance, guarantees and local currency financing, particularly to stimulate investment in infrastructure and private sector development, as well as managing exposure to risk and shocks.

AFD is also embarking on internal research in 2017 to adapt is financing tools and instruments to better support the private sector in fragile and other challenging contexts.

AFD had identified that its primary guarantee instrument for financing the private sector, ARIZ – a "risk-sharing mechanism", which provides guarantees to financial intermediaries providing lending to small and medium size enterprises (SMEs) – was not well suited to the challenges of fragile contexts. In the most challenging contexts, few eligible lending partners often exist, and while they might be interested in guarantees to reduce their overall risk exposure they are not always willing to extend credit to SMEs. Moreover, guarantees may be too costly and complicated to meet client needs, and since they do not currently cover first-losses, they do not cover sufficient levels of risk.

Recognising these challenges, AFD is embarking on research to document examples of leveraging private sector financing in fragile contexts, also identifying cautionary notes: including the length of time which may be needed to prepare projects; shortages of companies which can absorb significant levels of investment, which in turn has cost implications for investors; the need to have a robust understanding of the political economy; the potential to drive debt sustainability risks; and the need for functioning regulatory frameworks to support the use of blended finance.

AFD hopes to develop new specialised tools on the basis of this learning, that could include partial risk guarantees for investments, and creating local and regional investment funds targeting small enterprises in Africa, which are currently overlooked by conventional investors.

Sources: UNDP & AFD (2016) and donor interviews.

New approaches to managing risk will also be required

Scaling up investments in higher-risk contexts requires both new approaches to actively managing risk and pragmatism in accepting that not all risks can be managed. Actors who operate on a commercial basis face limits to the level of risk they can accept and the losses they can sustain, in the interests of protecting their shareholders' investments. The IFC is balancing an expansion into higher-risk investments with its requirement to operate on a financially sustainable basis by carefully managing its portfolio of risk, as well as devising new approaches to "derisking". In establishing the new Private Sector Window for financing, IFC and the World Bank have devised a new method of using concessional financing from the World Bank to reduce risks to IFC's portfolio, while supporting the Bank's strategic objectives and mandate to extend financing solutions to the poorest countries (IFC, 2016). However, IFC also signals a note of caution over its capacity to grow, which will depend in part on external macroeconomic conditions (noting that the recent market downturn has affected its overall profitability), progress in investment environments, the availability of capital and its own institutional capacity (ibid.). Meanwhile, the African Development Bank notes that there are limits to the amount of risk they can assume while maintaining a prudent overall approach to their financing portfolio (Box 3.4). And there are limits to that the private sector can reasonably deliver - in some cases, private sector projects may simply not be profitable investments, or may become unviable as circumstances change.[2]

Box 3.4. The African Development Bank's Private Sector Credit Enhancement Facility

The African Development Bank (ADB) created the Private Sector Credit Enhancement Facility in 2015 to expand its capacity to engage and invest in the private sector, particularly in fragile contexts. To date, more than 50% of the facility's investments have been in fragile states, including for example an energy project in Sierra Leone that will increase the country's power generation by 50% and the construction and operation of a new trans-shipment container terminal in Togo, which is expected to create 670 new permanent jobs and 2,000 temporary jobs during construction phase.

However, the uptake of other risk mitigating financing instruments such as Partial Risk Guarantees and Partial Credit Guarantees has been limited, particularly in fragile contexts; and over the last two funding cycles, only 8% has been channelled to fragile situations. The AfDB notes that the limitations are not all on the demand side. The AfDB's capacity to take on high-risk investments is finite. Investments tend overall to be smaller in these contexts, driving up the transaction costs of deals. The lack of instruments for local currency lending is also noted as leaving investors exposed to exchange rate risks.

Recognising the need for further investments in their capabilities and service offering, the AfDB agreed to use resources from Pillar III of their Transitional Support Facility to invest in capacity strengthening and reforms in the business environment and leveraging the reputation of the Bank to act as lead investment promoter in higher-risk contexts.

Source: African Development Bank

Partnerships will be critical for success; but there are barriers to collaborative working

Working more effectively in partnership with others has been codified in recent global policy commitments as fundamental to meeting global challenges; what this looks like in practice is not yet clear. Fragmentation across the UN system is acknowledged as problematic in both the 2015 UN Peacebuilding Review and the UN's Quadrennial Comprehensive Policy Review (QCPR), which draws attention to incoherence and competition on policy, and proliferation and territorial behaviour at the country-level (UN, 2017). There is growing recognition at the global policy-level that achieving the expanded scope of humanitarian, development and peacebuilding ambitions cannot be realised without working more effectively to leverage the comparative advantages of a wider range of actors and collaborating much more effectively. This emerging policy dialogue on partnerships was codified in 2015 in SDG Goal 17, "Revitalise the global partnership for sustainable development", which includes specific goals targeting improved collaborative working and "multi-stakeholder partnerships" (Box 3.5). In 2016 at the World Humanitarian Summit, a group of UN bodies signed up to a "Commitment to Action" which notes areas targeted for improved tools, approaches and partnerships among signatory UN agencies, including financing modalities calibrated to support collective outcomes.[3] In particular the need for strengthened partnerships between the World Bank and the UN has also been identified as key to delivering the SDGs (UN, 2017) and indeed in 2017, the World Bank and the UN are piloting approaches to supporting country-level collaboration in fragile and crisis-affected contexts.

Box 3.5. "Multi-stakeholder partnerships" targets under SDG Goal 17: "Revitalise the global partnership for sustainable development"

- Enhance the global partnership for sustainable development, complemented by multi-stakeholder partnerships that mobilise and share knowledge, expertise, technology and financial resources, to support the achievement of the SDGs in all countries, in particular developing countries.
- Encourage and promote effective public, public-private and civil society partnerships, building on the experience and resourcing strategies of partnerships.

Source: https://sustainabledevelopment.un.org

The next generation of partnership challenges exists at the country level, where incentives, including competition for funds and across operational mandates, still represent a significant barrier to collaborative approaches towards meeting collective outcomes. Operationalising the new global-level commitments to collaborative working is far less developed at the country-level and a range of system upgrades and modifications will be required in order to advance partnership aspirations. However, the more challenging barriers to collaboration – notably competition for resources and "structural disincentives and even prohibitions against mixing or pooling…. funding streams." (UN, 2017) have yet to be addressed. Financing can be used to create incentives towards supporting collective outcomes, but powerful structural disincentives and obstacles to change should not be underestimated.[4]

Risk management, prevention and preparedness struggle to attract sufficient investment

One of the most important roles for development finance is in funding critical gaps which will not otherwise be catered for by markets, governments or civil society. As global challenges change, new approaches to addressing risks and meeting collective responsibilities are required. Many see the future of development financing as underwriting these 'public goods'.[5] However, public goods cannot be financed on an ad hoc basis and currently, the key public goods of risk management, prevention, and preparedness consistently struggle to attract adequate investment.

Financing for preventing, managing and responding to risk remains marginal and fragmented, and disincentives have yet to be examined and addressed. Systematic under-investment in prevention is in part linked to under-investment in risk-sensitive context analysis, and in part a function of historic spending preferences and programming approaches – including powerful incentives for donors to support programmes which deliver predictable and attributable results (OECD, 2016a). New financing instruments have emerged, a number of which are designed to respond to political and economic shocks and opportunities (chapter 2). However, at the country-level, financing for prevention and risk is often under-prioritised and ad hoc and the balance of investments remains skewed heavily towards a small sub-set of the SDGs (UN, 2017). In addition to increasing the understanding of risk and making investments in prevention and resilience visible and prominent at the analysis and planning stages, new instruments and incentives to prioritise investments in prevention and preparedness, and a pragmatic assessment of donor constraints and trade-offs, are needed to shift this status-quo.

One key role of development finance can be to incentivise others to take action and invest early. For example, financial actors often make access to contingent credit lines conditional on putting in place a disaster management plan. And increasingly ODA is used to provide the technical assistance, set-up costs, and in some cases subsidies, that are required to set up sovereign and individual risk-financing transfer tools including catastrophe bonds, regional risk pools, and disaster insurance schemes.

States and individuals at risk 'own' their contingent liabilities. In the end it is they who will have to pay and therefore they are more readily persuaded to invest to prevent or make provision against future losses. But the liability does not fall so straight forwardly on international donors. They can still choose whether and how much to pay in event of a crisis and despite compelling evidence indicating a sound return on investment for early investments,[6] a range of institutional incentives still weigh heavily in favour of more costly, late response. In addition to pressure for attributable and measurable results – which are difficult to capture where losses are indeed avoided – there are compelling reasons for humanitarian donors in particular to avoid 'mortgaging' their limited funds by committing them against potential future risk, when financing demands to meet immediate acute needs already outstrip their available resources (FAO, 2017).

An analytical approach to financing decisions which considers the return on investment of prevention and preparedness actions over a range of investment periods can help to alter the calculations of decision-makers (UNICEF & WFP, 2015). In addition, donors may need to re-think the design of financing tools for prevention and preparedness, which calibrate the sequencing of payments and allow adequate duration for the delivery and measurement of returns. For example, ensuring liquidity up-front could involve leveraging private sector investment through debt instruments such as bonds. Institutions will also need however, to find ways of managing their structural disincentives to investing in prevention and preparedness. This may include creating protected envelopes, and developing more compelling evidence and narratives to 'sell' prevention and preparedness internally. It may also require the humanitarian system as a whole to invest in building greater ex ante contingent capacity to respond to peaks in demand, which in turn will reduce the disincentive to tie up funds in investing against future risk (FAO, ibid).

Policies, standards and reporting codes will need to be modernised to 'fit' the new financing landscape

Growing diversity in financing sources and actors brings risk and complexity as well as opportunity. INCAF members may have a particular role to play in revising, developing, promoting and upholding norms, standards and codes of behaviour and practice.

Mobilising private sector finance requires a range of additional considerations and complementary investments to avoid an inappropriate transfer of risk and debt from the private to the public sector. As noted in section 3, there are a range of potential risks associated with using concessional financing to leverage and incentivise private sector investment. Public-private partnerships (PPPs) in particular are noted as having a range of significant potential risks and have been entered into even in advanced economies without full understanding of the complexity of the deal or the debt burden incurred. There are real risks that information asymmetries and limited capacities of clients to understand complex financing packages may work in the favour of private sector actors, potentially leading to inefficient public sector subsidy of private investors, unsustainable debt burdens, and inappropriate projects that cannot be sustained (UNDP and AFD, 2016).[7] In addition, PPPs are often arranged "off budget" and are therefore not reflected in official debt statistics, making their contribution to debt sustainability difficult to detect and monitor.

In many fragile and crisis-affected contexts, these conditions and safeguards around private sector investments will often not be in place. For example, the OECD's guidance on PPPs recommends that governments should "establish a clear, predictable and legitimate institutional framework supported by competent and well-resourced authorities" (OECD, 2012), however this may be difficult to achieve in a fragile context. Therefore, it may be useful to pick up on the AAAA's proposal to support the technical capabilities of governments to enter into PPPs, while also developing guidelines for the use of PPPs as well as building a knowledge base and sharing lessons through regional and global forums.

It may also be useful to articulating a positive narrative and set of characteristics of 'good' sustainable private sector investment. While many international standards for responsible business practices already exist, the characteristics of investment which promotes or contributes substantially to sustainable development have yet to be defined (Sauvant, in OECD, 2016c). An established consensus on the characteristics of "sustainable foreign direct investment" could in principle assist investors (including development financing actors), and government looking to attract investment, to make more targeted and informed investments (ibid.). The newly adopted OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs are an example of efforts to frame and guide private sector investment in support of positive contributions to sustainable development.[8]

Promoting and supporting the capacity to enforce and hold public and private sector actors to account against international standards for responsible business may be a key role of development actors in future. Encouraging foreign investment without adequate protections in place, including for the environment and for the rights of citizens, has the potential to create a new generation of risks, including deepening inequality, driving grievances, and increasing environmental degradation. Donors can support targeted investments in the development and implementation of guidance, legislation and policy as well as supporting transparency and accountability mechanisms to protect the rights of vulnerable populations, the environment and to avoid exacerbating conflict risks.

Donor support to a range of initiatives in Myanmar provides an illustration of challenges and programmatic responses. In the last few years, large land concessions have been awarded to foreign investors, in the current context of limited transparency, and a weak legislative and regulatory environment[9], the potential for serious negative social and environmental impacts, which could in turn impact on political stability, is significant. Concessions have reportedly been awarded in former conflict areas where displaced people may yet wish to return to lands, which have now been awarded to private investors (Burnley et al. 2017). Oil and gas extraction has become a key conflict driver and point of contention in demands for constitutional change (Myanmar Centre for Responsible Business (MCRB) et al. 2014). The government of Myanmar has signalled a strong commitment to responsible business, including committing to develop a national action plan for implementation of the UN's Guiding Principles on Business and Human Rights, as well as a range of other standards and principles, including the Extractive Industries Transparency Initiative (EITI), with support from a range of development partners. The Myanmar Centre for Responsible Business provides a forum for dialogue and technical advice for business and government in meeting commitments to responsible business (Box 3.6). Legislation and enforcement mechanisms however lag behind these principled commitments, with the government working through a huge backlog of revisions to existing legislation and creation of new legislation.

Box 3.6. The Myanmar Center for Responsible Business (MCRB)

The MCRB is a joint initiative of the Institute for Human Rights and Business (IHRB) and the Danish Institute for Human Rights (DIHR) and is currently funded by the governments of Denmark, Ireland, the Netherlands, Norway, Switzerland, and the UK.

The MCRB provides a neutral platform for dialogue and provides technical support, analysis and advice to a range of actors including national and international business, governments and civil society to support more responsible business practices.

The MCRB has carried out four sector-wide impact assessments on key investment areas, including oil and gas, mining, ICT and tourism, which consider the social, environmental impact of business, with a human rights perspective. These SWIAs which provide a comprehensive picture of policy, regulatory, and societal challenges and make recommendations for a range of public and private sector actors to promote awareness and compliance with international standards for responsible business.

Source: www.myanmar-responsiblebusiness.org

At the global-level, donors can also provide technical expertise and support the development of guidance and norms. For example, Norway, as an oil and gas exporting economy, has considerable institutional expertise in governance and management of oil revenues, which it extends to developing countries in support of more effective and accountable management of oil production and revenues through the Oil for Development programme (Box 3.7). Meanwhile France, Germany, the UK and US, have supported the development of the Analytical Framework for Responsible Land-Based Agricultural Investments, which helps investors to align their policies and actions with guidelines on responsible land-based investments, notably the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security (VGGT) and the Guiding Principles on Large Scale Land Based Investments in Africa (LSLBI). Notably, the framework includes red lines that indicate in which situations investment projects should be cancelled if no benign alternatives can be found.

Box 3.7. Norway's Oil for Development programme (OfD)

The petroleum sector may yield substantial revenues but in fragile contexts, it can also pose significant risks. Revenues may dwarf those of other sectors, and discourage economic diversification; governments reliant on oil revenues rather than taxing their citizens are less likely to be responsive to public pressure; revenues are vulnerable to volatility as global market prices fluctuate; and the oil industry can provide lucrative rent-seeking opportunities for government officials and business. Oil-producing developing countries have in many cases not lived up to their developmental potential considering their relative wealth. Many have become less democratic since the 1980s, are more likely to experience violent insurgencies, and their economies have failed to grow in line with their potential (Ross, 2012).

As an oil and gas producing state, Norway has a wealth of institutional experience in effective and accountable governance of oil production and established its Oil for Development programme (OfD) in 2005 to extend its technical expertise to developing oil economies on resource, financial, safety and environmental management as well as strengthening accountability through engagement of civil society actors, parliamentarians and the media. OfD draws on expertise from a range of Norwegian public institutions including the Norwegian Petroleum Directorate, the Norwegian Environment Agency, the Petroleum Safety Authority Norway, the Norwegian Oil Taxation Office, the Norwegian Coastal Administration and Statistics Norway. Norway also works with the World Bank and IMF through a series of trust funds, with the UN Environment Programme (UNEP) and with civil society organisations. OfD was operational in 12 countries in 2016, including Angola, Cuba, Ghana, Iraq, Kenya, Lebanon, Mozambique, Myanmar, South Sudan, Sudan, Tanzania and Uganda.

The OfD programme has been found to be most effective in supporting emerging petroleum economies to establish more democratically responsive systems and procedures (Norad, 2013). However, enabling political environments are also critical to the success of programmes and engagement may in reality have to be scaled-up and down depending on the political space for reform. In Lebanon for example, the long-standing political deadlock in government meant that legislation and decrees enabling the next round of exploration licensing have not been approved (Norad, 2016) and after ten years of engagement, the future prospects for the programme remain unclear. In South Sudan meanwhile, the OfD programme was suspended in 2016, as insecurity and political instability dramatically shrunk the scope for reform and capacity-strengthening work.

Source: Donor interviews

Statistical monitoring systems and incentives have yet to catch up with the evolving role of ODA and the full scope of development financing investments. There are a range of new forms of financing, as well as growing diversity and complexity in the cast of financing actors and the range of flows and instruments that will be required to deliver Agenda 2030. However, the OECD's current ODA reporting system, the Creditor Reporting System or CRS, does not capture the catalytic or leveraging effects of ODA investments, or specific tools such as blended finance and risk mitigation instruments. This lack of public recognition of donor efforts can constitute a structural disincentive to scaling up these types of investments. A new approach to capturing a more comprehensive picture of financing efforts from official actors, Total Official Support for Sustainable Development (TOSSD), is currently under consultation and development with the support of the OECD (Box 3.8).

Box 3.8. Capturing Total Official Support for Sustainable Development (TOSSD)

Recognising that a growing proportion of funds for sustainable development come from sources other than official development financing, the AAAA called for the OECD to work with the international community to devise a new approach to statistical measurement of financing flows for development.

TOSSD aims to capture a far wider range of flows, from a broader set of actors, which will better capture provider contributions and give a fuller picture of relevant financing flows for development from the recipient perspective, helping to inform policy discussions, decision-making and targeting of resources.

TOSSD will be proposed as an international statistical standard to be endorsed by the UN, against which official bilateral and multilateral institutions and South-South providers will report SDG-relevant resource flow data. The OECD has been carrying out broad consultations to help define the scope and focus of TOSSD and is working with other members of the Inter-agency Task Force on Financing for Development (IATF) to reach international agreement on the scope and method of TOSSD in 2018. TOSSD data is expected contribute to international reporting on SDG implementation at the UN-hosted High Level Political Forum in 2019.

Source: OECD (2017a)

Measuring the impact of investments in enabling environments is challenging. Accounting for the impact of investments in enabling business environments is not straight-forward. For example, the economic impacts of investing in the domestic financial sector are indirect and therefore difficult to meaningfully capture. Existing measures including the World Bank's Ease of Doing Business Index, which tracks a range of indicators on a regular basis, may not be well suited to capturing the right balance of constraints and priorities relevant to a particular context (Glanville et al. 2016). New approaches and indicators to measure the impact of investments in enabling conditions therefore are needed.

Tensions between domestic political priorities and stabilisation goals will need to be overcome

While governments have committed to a new and ambitious global sustainable development and climate change agenda, their domestic political priorities can sometimes be in tension with these commitments.

Emerging trends towards aligning investments with donor country national interests may undermine stabilisation goals. There are a number of indications of a shift among bilateral donors towards more explicit use of aid to serve national interests – both foreign policy and, in some cases, economic policy.[10] These may be in tension with sustainable development, peacebuilding and climate change policy commitments. In addition, it may prove challenging to reconcile the management of perceived risks to national interest posed by fragility – such as tackling violent extremism and reducing the drivers of migration – with policy commitments to support locally led state-building and peacebuilding processes.

In Lebanon, there is a strong sense among development financing actors that as a consequence of high levels of migration from 2014, the overriding concerns of bilateral donor governments shifted from a humanitarian response towards containing refugees in the region. One of the primary stated purposes of the EU's Madad fund, for example, is to respond to "EU political priorities in the region", with objectives listed as stabilising overstretched host countries (Turkey, Lebanon, Jordan and Iraq) and to "reduce the pull factors and root causes of the migration crisis (in the entire region)" (EU, 2016). Some donors have questioned the extent to which the Madad fund, and the new EU Emergency Trust Fund for Africa are compatible with commitments to support country-led prioritisation (Haulk et al., 2015). And more broadly in Lebanon, the prioritisation of funding, expected levels of accountability and impact were felt by a number of development financing actors to be adversely influenced by the political concerns of donors, including the need to keep funds flowing.

Meanwhile, rapid growth in ODA spending on refugee-related costs in donor countries has been reported, from USD 3.4 billion (2.7% of total ODA) in 2010 to USD 12 billion (9.1% of total ODA) in 2015 (OECD, 2016) which, if not offset by increases in ODA spending overall, risks reducing ODA for the poorest countries.[11]

The potential risks associated with leveraging private financing may be amplified where supply-side or donor-driven interests compete with or outweigh developmental priorities. There are a range of risks associated with leveraging financing from the private sector which require careful management to ensure that investments contribute effectively to development, peacebuilding and resilience goals and avoid doing harm. Some of these risks include providing unfair advantages to international investors and "crowding out" local investors, potentially incentivising unsuitable projects that incur unsustainable debts and contributing to environmental and conflict risks. Where donors have a strong incentive to promote their own national trade interests, the potential for these risks to be downplayed is potentially increased. There are also concerns that a growing private sector agenda in aid could lead to an increase in tied aid, in contradiction with aid effectiveness commitments.[12] Charlotte Petri Gornitzka, current chair of the OECD Development Assistance Committee notes for example "there is concern that the private sector agenda could be used as an excuse for more tied aid. And there is concern that an uptick in tying is a precursor of more of this to come in the future." (Gornitzka, 2017). While the majority of ODA remains untied, the proportion of aid reported as untied fell from 87.1% in 2014 and 83.5% in 2015 (OECD, 2017b). These levels are noted as high by historic standards, and careful monitoring and analysis of the drivers of increased tying of aid will be required (ibid).[13]

In order to guard against these risks and avoid doing harm, retaining a strong focus on prioritising and monitoring the developmental impact of all financing flows – public and private, international and national – needs to be systematically integrated into programme design.[14]

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Notes

[1] Perhaps most notably, a fragility assessment of the causes and features of fragility is considered the basis for developing a single vision and plan, and joint risk assessment fundamental to building mutual trust as part of the New Deal for Engagement in Fragile States.

2 For example, a cocoa and coffee trading and block-farming company in Sierra Leone in which AATIF invested USD 1 million in 2013 ran into difficulties in 2015 during the Ebola crisis, and the first tranche of the loan was written off as a total loss in 2014. By 2015, AATIF considered that only grant funding would allow the company to turn around its operations (AATIF, 2016).

3 The Commitment to Action was signed by the UN Food and Agriculture Organisation (FAO), Office for the Co-ordination of Humanitarian Affairs (OCHA), UN High Commission for Refugees (UNHCR), the UN Development Programme (UNDP), the UN Children's Fund (UNICEF), the UN Population Fund (UNFPA), the World Food Programme (WFP), World Health Organisation (WHO) and endorsed by the International Organisation for Migration (IOM) and the World Bank, and has stimulated a range of new collaborative approaches and instruments, with many more scheduled for testing and roll-out in 2017.

4 In Lebanon for example, the UK and EC jointly agreed to tender for a single provider for unconditional multipurpose cash grants for refugees in order to improve efficiency and transparency. Programme monitoring was to be allocated to a second party. The major UN agencies – UNHCR and WFP – declined to "compete" for the contract and made a joint proposal with a leading NGO consortium, arguing that their roles were complementary. The bid was rejected.

5 The Center for Global Development (2016) argues for example that a key role for multilateral development banks should be in financing global public goods.

[6] A study of return on investment (RoI) in DFID-supported preparedness activities and investments across UNICEF, UNHCR, OCHA and WFP programmes demonstrated that every USD 1 invested early returned a median saving of USD 1.50 in the next emergency response, as well as saving 14 days in response time on average and making significant carbon savings. Across the 84 interventions studied, involving in total USD 11.1 million, USD 20.3 million in savings was generated in the following emergency alone, and savings continued to accrue across subsequent crises. The RoI analysis was carried out by the Boston Consulting Group and PwC, who have developed a methodology for conducting such analyses and plan to make it publicly available. (FAO, 2017) based on information provided by DFID, based on UNICEF analysis presented at ECOSOC 2017.

[7] Loxley and Loxley (2010), in Jomo et al. (2016) researched PPPs in Canada and found they were more costly to build and finance, provided poorer quality services and were less accessible, and less accountable to citizens than publicly financed alternatives. They concluded the primary motivation for pursuing PPPs was to shift project debt off-budget. Private investors meanwhile enjoyed low levels of risk.

8 The OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs were adopted at the OECD DAC High Level Meeting, 30-31 October 2017.

9 Notably, Myanmar does not have a written policy on land use and land tenure. https://usaidlandtenure.net/country-profile/burma/

10 The UK's 2016 Aid Strategy, for instance, spells out a strong commitment to balancing its commitments to poverty reduction with the national interest: while spending in fragile and conflict-affected states will increase to 50% of UK ODA, these investments have multiple stated objectives ("address current crises, the root causes of migration, and the threats posed to the UK by the ongoing conflict"), which may prove challenging to reconcile in practice.

11 As described at: http://www.oecd.org/dac/financing-sustainable-development/refugee-costs-oda.htm

12 The OECD introduced commitments promoting untying of aid to the least developed countries in 2011. Commitments to reducing tied aid are included in the Accra Agenda for Action and the 2011 Busan Partnership for Effective Development Cooperation, which notes "Pursuant to the Accra Agenda for Action, we will accelerate our efforts to untie aid. We will, in 2012, review our plans to achieve this. In addition to increasing value for money, untying can present opportunities for local procurement, business development, employment and income generation in developing countries. We will improve the quality, consistency and transparency of reporting on the tying status of aid." (High Level Forum on Aid Effectiveness, 2011).

13 Charlotte Petri Gornitzka, current chair of the OECD Development Assistance Committee notes for example "there is concern that the private sector agenda could be used as an excuse for more tied aid. And there is concern that an uptick in tying is a precursor of more of this to come in the future. So far, the analysis of the untying report has not substantiated the concern – although it will be important to continue monitoring this carefully." (Gornitzka, 2017)

14 Development Initiatives (2016), for example, argue: "The guiding principle for donors should be that the role of ODA in blended finance increases available resources for targeting poverty, rather than pursuing private investment through blending as an end in its own right."

Conclusions: What lessons can we derive?

A major shift in how development financing actors conceptualise their roles is underway – from being cash-dispensers to becoming strategic investors, market enablers and providers of public goods. Development financing actors have a range of tools in their repertoire spanning resources over which they have direct control (classic ODA grants and loans), to resources that can be directed to incentivise other types of financing (a range of blended finance tools, as well as traditional guarantees), to investments which can create the enabling conditions for the mobilisation of financial flows over which we do not have direct control (budget allocations by the governments of fragile contexts) but which are likely to deliver against longer-term macro-economic growth and job creation goals. A broadened emphasis in the role of ODA from a direct transfer of resources to the inclusion of the strategic use of ODA to mobilise, leverage and enable other flows however, poses a range of challenges to the existing repertoire of tools and instruments, and the technical capabilities and partnerships of development financing actors. Development financing actors are in the early stages of adjusting their instruments, approaches and institutional capabilities to meet these new challenges.

Delivering against these new aspirations will require a range of further institutional reforms and investments and a dose of realism. The role of ODA in incentivising and enabling other types of finance is now beginning to enter mainstream policy discourse and an array of new tools, instruments and approaches are emerging. In order to scale up investments and to apply a more diverse financing tool-kit in crisis-affected, fragile and at-risk contexts however, development financing actors will need to invest in new technical capabilities, physical presence or proximity, more robust approaches to understanding and managing risk, and the potential impacts of investments as well as and updated standards, codes, guidance and monitoring tools to ensure investments meet priority financing needs, without inadvertently causing harm. While many institutions have signalled their commitment to work to address the challenges of fragility, crisis and risk, so far, few have significantly increased their staffing capacities at country or regional level, altered their management approaches to enable flexible, risk-tolerant approaches at the country level, or embedded institutional incentives to work collaboratively.

Development financing actors should also proceed with care with some of these newer instruments, particularly blended finance tools, which seek to mobilise financing from private and other official investors, which may not be viable and appropriate in each and every crisis-affected and fragile context. In the current rush of enthusiasm for mobilising private sector financing, development financing actors will need to retain a sharp focus on the developmental benefits and sustainability of outcomes, to avoid creating inappropriate and unsustainable investments. And even with the most artfully designed and heavily incentivised financing vehicles, in some high-risk contexts, there will be risks which cannot be managed or mitigated and where therefore, private sector investment is unlikely to materialise.

During this dynamic period of reflection, reform and innovation, the support of major development financing actors to these processes will be critical. The political, financial and intellectual support of bilateral donors both directly, and as governing members of multilateral institutions, plays an important role in stimulating and enabling change. However, while advances are rapidly being made in financing tools, instruments and approaches, particularly at the global-level, aligning the political and economic priorities of bilateral donors with country-level priorities adds a further dimension of complexity, and runs the risk of establishing competing incentives, that require careful management. Continuing work to support field colleagues to develop financing strategies – the right amount of finance, using the right tools, for the right time, to provide the right incentives – will be a useful next step.

Annex A. “Official” financing flows for development in fragile, crisis-affected and at-risk contexts

Official flows for development include a range of flows over which “official” or government actors have direct influence or control. In OECD DAC statistics, these include Official Development Assistance (ODA), concessional financial flows whose primary purpose is development; and Other Official Flows (OOFs). OOFs include a range of flows provided or backed by government, which may contribute to development, and which may be concessional in their terms, but which do not meet the strict criteria of ODA.

Official actors who are not members of the OECD DAC also provide concessional financing for development purposes. These flows are not reported as ODA, though they share many characteristics. These flows originate from a range of official sources and vary widely in size, focus, instruments and approaches and visibility. They include South-South cooperation and Triangular flows.

The DAC first defined ODA in 1969 and periodically adjusts and refines the definition. The current definition of ODA is as follows:

“those flows to countries and territories on the DAC List of ODA Recipients and to multilateral institutions which are:

i. provided by official agencies, including state and local governments, or by their executive agencies; and
ii. each transaction of which:
    a. is administered with the promotion of the economic development and welfare of developing countries as its main objective; and
    b. is concessional in character and conveys a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent).”

ODA grants: The majority of ODA spending in contexts affected by fragility, crisis and risk is provided in the form of grants, which constitute transfers in cash or in-kind, for which there is no legal expectation of repayment from the recipient. In 2015, 81% of ODA channelled to countries on the OECD’s fragility spectrum in 2016 was provided in the form of grants. ODA grants come in a wide variety of forms, with varying degrees of flexibility and conditions. Of note in fragile contexts, the use of country-based pooled financing mechanisms has been a major innovation in supporting alignment with country-led priorities. New instruments enabling budget support or very close alignment with government systems are also emerging, including EU Statebuilding contracts and the Australian government’s support to channelling funds through governments in the Pacific region on a payment-for-results basis.

ODA loans: ODA loans may take a wide variety of forms and recent adaptations in loan products tailored to the requirements and capacities of fragile and at-risk contexts have emerged, including instruments which enable governments to manage the financial impact of a range of shocks, and new instruments blending grants and loans to soften the terms of concessional loans.

Debt relief: Debt reorganisation or restructuring, sometimes referred to as debt relief, includes forgiveness or writing-off of all or part of an existing debt, and a range of modifications to ease the terms of repayment, including revising repayment schedules or providing revised financing terms.

Reducing debt liability and the amounts spent on servicing debt helps to maintain government fiscal sustainability, including increased flexibility or fiscal space to allocate funds to manage shocks and crises (counter-cyclical spending). Many governments inherit long-standing debt from previous regimes, which limits their creditworthiness and therefore their ability to invest in developmental priorities. Reducing their overall debt burden through debt rescheduling may open opportunities for new lending.

Other Official Flows (OOFs) are a category of financial flows defined by the OECD which includes transactions by the official sector with countries on the OECD List of Aid Recipients but which do not meet the conditions for eligibility as ODA, either because they are not primarily intended for development purposes, or because they are not sufficiently concessional. OOFs include:

- Official bilateral transactions intended to promote development, but having a grant element of less than 25%.
- Grants to developing countries for representational or essentially commercial purposes.
- Official bilateral transactions, whatever their grant element, that are primarily export-facilitating in purpose. This includes:
- export credits extended directly to an aid recipient by an official agency or institution (official direct export credits);
- the net acquisition by governments and central monetary institutions of securities issued by multilateral development banks at market terms
- subsidies (grants) to the private sector to soften its credits to developing countries;
- funds in support of private investment.

In 2015, USD 31 billion in OOFs, excluding export credits, flowed to developing countries, with USD 9 billion reaching countries classified by the OECD as at risk of violence and fragility. Of this USD 9 billion, the vast majority was concentrated in middle income countries.

Export credits: Export credits include a range of financial incentives and risk mitigation tools provided by governments to national companies to promote exports. These credits are commercially-motivated and have no explicit objective of promoting economic development and welfare in developing countries. However, export credits can help to mobilise private capital investments in developing countries, including for infrastructure, energy and productive sectors. Officially supported export credits include credits or loans issued directly by Export Credit Agencies (ECAs), and loans extended by the private sector to finance exports, which are guaranteed or insured by official ECAs. Export credits are demand-driven and meet the needs of developed country-exporters first and foremost. There is limited scope therefore to influence their sectoral priorities or to align with national priorities in the recipient country.

Guarantees: A guarantee is a risk-sharing agreement similar to an insurance policy, whereby a guarantor agrees to pay part or the entire amount due on a loan, equity or other instrument to the lender/investor in the event of non-payment by the borrower, or loss of value in case of investment. Guarantees typically cover political and/or commercial (e.g. credit, regulatory/contractual) risks that investors are unwilling or unable to bear. Guarantors use a range of tools including reinsurance, co-guarantees, or reserve assets to transfer, diversify or cover identified risks.

Guarantees reduce the risk of lending, enabling borrowers to borrow at more favourable terms and can help to “crowd in” financing from other sources so that a relatively small financial commitment from the guarantor may leverage or mobilise far larger volumes of funds from the private sector.

Guarantees for “development” should meet the criteria of promoting the economic welfare and development of developing countries as the principal objective. Development guarantees are typically concentrated in more stable markets, notably middle-income countries and overall, their use is somewhat limited.

Because guarantees are a contingent liability rather than a flow, unless they are invoked, they are not reflected in statistics on development financing flows. However, guarantees are counted against a country’s exposure limit with multilateral development banks on a similar basis as loans. Therefore, while issuing guarantees may not represent a net outflow, it nevertheless represents a liability and it may reduce the capacity of a government or institution to issue credit.

The majority of development guarantees are provided by multilateral development banks and agencies, notably the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group, the Islamic Development Bank (IDB) and the Private Infrastructure Development Group (PIDG).