››› Blending: a useful extension of the scope of development finance instruments

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In the context of development finance, the term “blending” describes every form of combining market funds with concessional funding elements (interest relief, risk reductions, repayment relief, etc.). Traditionally, blending is mainly practised by national or international development banks, primarily by combining public grants with market funds raised by them on international financial markets, so that they can offer the partner countries (concessional) development loans at lower overall interest rates.

Mobilising money to finance development with limited public funds

Several developing countries have made good economic progress in recent decades and have thus gained better access to international financial markets. With the loans available there, they can now finance highly profitable development projects based purely on market funds, even independently of development assistance.

However, many investments that are developmentally important do not (yet) reach this self-financing threshold – also because interest rates for developing countries on the international financial markets are usually particularly high (due to fairly low credit ratings which reflect a higher risk of default). If just a few public funds are added, however, the financing conditions can often be “softened” to a level which becomes manageable for the partner/project. Ultimately, by adding relatively few public funds, development banks can mobilise high volumes of market funds to finance developmentally important investments.

The quantitative relationship between public funds and market funds is also called "leverage ratio": the smaller the share of public funds needed, the greater the "leverage effect" to mobilise market funds.

Blending as a bridge between grants and market financing

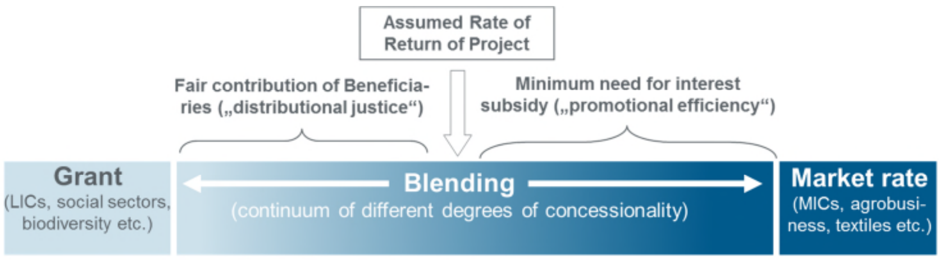
Development banks contribute in two ways to adapting financing conditions to the need of development investments. On the one hand, due to their generally very good corporate/sovereign rating, they can mobilise market funds on the international financial markets at significantly better conditions than developing countries. On the other hand, they can adjust the financing conditions exactly to the needs and abilities of the borrower by flexibly adding grants. Blending can cover the entire space between pure grant financing and pure market-based financing (see graph) and is therefore particularly suitable for providing flexible support to partner countries making the transition from pure aid recipients to creditworthy borrowers.

The right balance: optimising promotional efficiency and distributive justice at the same time

Compared to pure grant financing, concessional development loans represent "tougher" financing conditions for the borrower. Public funds are only added in the amount absolutely necessary to implement the project in the first place (no "over" funding at the expense of public budgets and no "under" funding at the expense of the target groups who should benefit from the project). From the donor countries' point of view, the use of scarce budget resources can be limited to what is absolutely necessary to achieve the developmental goal efficiently (high promotional efficiency preserves scarce public funds). At the same time, however, it also optimises distributive justice among recipients: the weaker the partner country and the higher the need to subsidise a project (e.g. due to the limited ability to pay of poorer target groups), the "softer" the financing conditions. Blending can therefore be used to cover a wide spectrum of financing needs, while pure grants are often still needed for the poorest countries, the alleviation of ultra-poverty and global public goods.

Where is blending particularly suitable/not at all suitable?

Concessional development loans are particularly suitable for financing projects that are economically beneficial from a national developmental perspective, but that do not (yet) generate sufficient (microeconomic) income to cover the full debt service (if financed at market terms). Blending is therefore a very useful and efficient way to extend the scope of international development finance instruments, but its use is restricted to countries/ projects that can generate sufficient income to reliably bear concessional interest rates and repayments. A prerequisite for the use of blending instruments is always a strict appraisal of debt sustainability.■



Source: author's representation