

INVESTMENT PERSPECTIVES

How Much Subsidy Is Enough? Rethinking Concessionality in Blended Finance

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Introduction

Blended finance is often framed as a solution to funding shortages, particularly within the context of the ever-growing and seemingly unfillable Sustainable Development Goal (SDG) financing gap. Yet one of the more significant bottlenecks facing blended finance may not be the quantity of capital available, but the inconsistent ability to determine the appropriate level of concessionality (the public or philanthropic subsidy amount) required to support development investments.

The problem with pricing concessionality

Across blended finance transactions in emerging markets and developing economies (EMDEs), concessional capital is routinely deployed to “de-risk” investments. Instruments such as guarantees, subordinated tranches, and concessional loans are increasingly used to mobilize private sector capital.

Blended finance approaches are expanding, albeit at a pace falling short of the “billions to trillions” ambition set out in the 2015 Addis Ababa Action Agenda. However, there remains limited consensus on a basic question: how much concessionality is actually necessary?

With public finance becoming increasingly scarce, as reflected in last year’s [historic 23.1% contraction of Official Development Assistance \(ODA\) according to Organisation for Economic Co-operation and Development \(OECD\) statistics](#), concessionality will need to be deployed far more strategically.

If used excessively, it can distort markets, crowd out local commercial actors, and over time potentially weaken incentives for continued private participation. If deployed insufficiently, investments in EMDEs and underfunded sectors may never materialize. Yet uncertainty persists around how concessionality should be calibrated and conceptually defined.

Concessionality is not just about risk: different constraints, different subsidies

Much of the blended finance ecosystem still implicitly treats concessionality as synonymous with risk absorption. In practice, this usually means using concessional instruments to compensate private investors for increased credit risk, political risk, fragility, or volatility. This logic underpins many blended finance structures and is reflected in both the [OECD Blended Finance Principles](#) and the [Development Finance Institution \(DFI\) Enhanced Principles for Blended Concessional Finance](#), which emphasize minimum concessionality, along with crowding-in and commercial sustainability.

However, concessionality should be aligned closely with both the [underlying participation and behavioral constraints](#) preventing private investment. This shifts concessionality away from a generic subsidy for “high-risk” projects and toward a more targeted response to specific market failures. In practice, concessionality may therefore compensate for a broader range of constraints reflected in both measurable and less measurable forms of risk, where the returns required by investors may not align with underlying development value.

One important but under-theorized category is information concessionality. Investors do not always avoid investments because risks are objectively high. Often, they avoid them (or price the risks very generously) because data is limited and track records are weak. In these cases, concessionality functions less as insurance against risk and more as a signaling mechanism that reduces information asymmetries.

[As Frank Knight argued over a century ago](#), measurable risk differs fundamentally from unquantifiable uncertainty. Risk can, at least in principle, be modelled and priced. Uncertainty cannot. Yet blended finance practitioners and structures frequently treat the two interchangeably.

Another overlooked category is time horizons. Many development investments across EMDEs involve long gestation periods, delayed returns, and benefits that accrue over decades rather than quarters. Research suggests that investments made in sectors such as [climate adaptation](#) and [blue finance](#) may generate substantial long-term development value while remaining commercially unattractive within the shorter investment horizons and liquidity expectations of private investors. Here, concessionality may instead be compensating for temporal mismatches between development timelines and private capital expectations.

A third category is externality concessionality. Research also highlights [how markets continue to undervalue climate resilience, biodiversity protection, social inclusion, and other public goods because many of their benefits cannot be fully monetized by private investors](#). Some development objectives may require persistent subsidy because markets systematically underprice broader social returns.

Finally, concessionality often plays a critical market-building role in EMDEs. In some sectors, transaction costs remain high, regulatory frameworks immature, and enabling environments weak. Here, concessionality may help establish [new asset classes, coordinate participation, or create demonstration effects that enable future commercial investment](#).

As we've seen from the above examples, blended finance practitioners are pricing multiple market constraints simultaneously, creating several challenges for concessionality calibration.

First, there is no observable market price for concessionality. There is [limited public data](#) on realized defaults, recovery rates, loss distributions, or optimal tranche sizing across blended finance structures. [Subsidy levels are therefore often negotiated rather than systematically priced](#).

Second, differences in the [measurability of risk](#) can complicate concessionality calibration. Measurable risks such as default rates are fundamentally different from risks related to uncertainty arising from unfamiliar markets or limited information. But concessionality is routinely used to cover both, even though they may require very different interventions.

Third, there is little meaningful counterfactual analysis. In many cases, [institutions cannot confidently determine whether private capital would have participated with lower subsidy levels, or without subsidy at all](#). Without feedback loops linking concessionality to mobilization outcomes, pricing strategies remain weak and learning remains limited.

As such, blended finance should not be assessed solely through mobilization metrics, but through its capacity to [address structural market barriers and support long-term market creation](#).

What are some potential solutions?

If concessionality is indeed a pricing problem under incomplete information, improving blended finance may require more than simply increasing capital volumes. One potential avenue could be moving beyond the question of “how much concessionality is needed?” and instead asking: what constraint is being addressed? Different constraints should require different pricing approaches, whether related to measurable risk, uncertainty, externalities, or market-building objectives.

As such, DFIs and Multilateral Development Banks (MDBs) should move toward more systematic benchmark frameworks for concessionality, helping to provide an indicative reference range by sector, instrument, and constraint type.

One such example is the [International Finance Corporation \(IFC\) Disclosure Portal](#), which discloses IFC project-level data including concessionality amounts, providing a step in the right direction that other MDBs should follow. Such initiatives should be complemented with broader efforts to strengthen data transparency across the blended finance ecosystem. Initiatives such as the [Global Emerging Markets Risk Database \(GEMs\)](#) (not yet fully publicly available), which pools long-term MDB and DFI default data, illustrate how shared datasets could help to improve understanding of actual versus perceived risk. Similar approaches for sharing concessionality information could support more evidence-based calibration.

Concessional finance will remain essential where private capital alone may not flow at sufficient scale, but as public resources become increasingly constrained, its effectiveness will depend not only on how much subsidy is provided, but on what exactly concessionality is intended to compensate for.

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