

# RESEARCH KEY FINDINGS



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## A Framework for Evaluating Private Sector Mobilization by Public Development Banks

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### Objectives & Research Questions

Our paper aims to provide an overarching analytic framework for public development banks (PDBs) to evaluate the use of blended finance for private sector mobilization (PSM) with a public interest and to guide how to make the best of it.

Our paper addresses three questions:

- (1) What is the case for PSM?
- (2) What are potential downsides of PSM?
- (3) What tools can PDBs deploy to optimize PSM?

This paper makes two main contributions. First, it analyzes theoretically the differential social costs of PDB direct financing and blended financing, which is useful to evaluate the debate over the merits and pitfalls of the “from Billions to Trillions” agenda. Second, it explores how to use selectively some of the tools at the PDB disposal to make the most of blended finance in practice.

### Methodology

Our paper is an applied theoretical model. First, it builds a rich model that analyzes the tradeoffs involved between the use of blended finance and direct PDB financing. Second, it also relates to a recent work by Flammer, Giroux and Heal (2024) where they posit a simple model for the PDB to evaluate how to best allocate scarce subsidies to crowd in private capital across projects (essentially, higher societal returns merit higher subsidies) and use it to empirically confirm hypotheses using IFC data. Our paper is consistent with this approach but uses a richer model to analyze the pros and cons of blended financing rather than take it for granted as the best strategy.

Flammer, C., Giroux, T., & Heal, G. (2024). [Blended Finance \(No. w32287\)](#). National Bureau of Economic Research.



## Results

First, even though there is a solid case for PDBs to follow a PSM strategy to avoid the social cost of expanding the public sector balance sheet with PDB direct financing, especially in debt-distressed countries, any increase in overall development financing that may be brought by PSM will require additional fiscal resources to the PDBs to put it in motion.

Second, PSM may suffer from the following drawbacks: a) excessive private caution, b) the incentive of private parties to extract excessive subsidies from the PDB, and c) the lack of incentives of private parties to ensure that their financing is directed to the projects with the highest development impact.

Third, excessive private caution calls for structuring subsidies to provide insurance against income variation and negative shocks in the form of equity-like subsidies, guarantees, and cofinancing. Subsidy minimization and development impact maximization to obtain more and better PSM within the budget envelope calls for auction mechanisms to allocate PDB support to well-defined financing targets.



## Recommendations

The mobilization of private sector finance prompted by PDBs is a means towards achieving a higher development impact, rather an end in itself. PSM can be expected to be part of the best solution in many cases, but it should not be assumed to be. Rather, the PDB should analyze how to use its tools to make PSM the best it can be by easing frictions to private sector participation and finding smart ways to blend its financing to address the downsides of PSM. Weaker PDBs lacking the capabilities to manage these tools may be better off not turning to PSM until they are developed.

**See:** Eduardo Fernández-Arias and Jiajun Xu\*. A Framework for Evaluating Private Sector Mobilization by Public Development Banks. Public Development Finance Research Program Working Paper, Peking University, 2025. (\*corresponding author, Email : [jjajunxu@pku.edu.cn](mailto:jjajunxu@pku.edu.cn))