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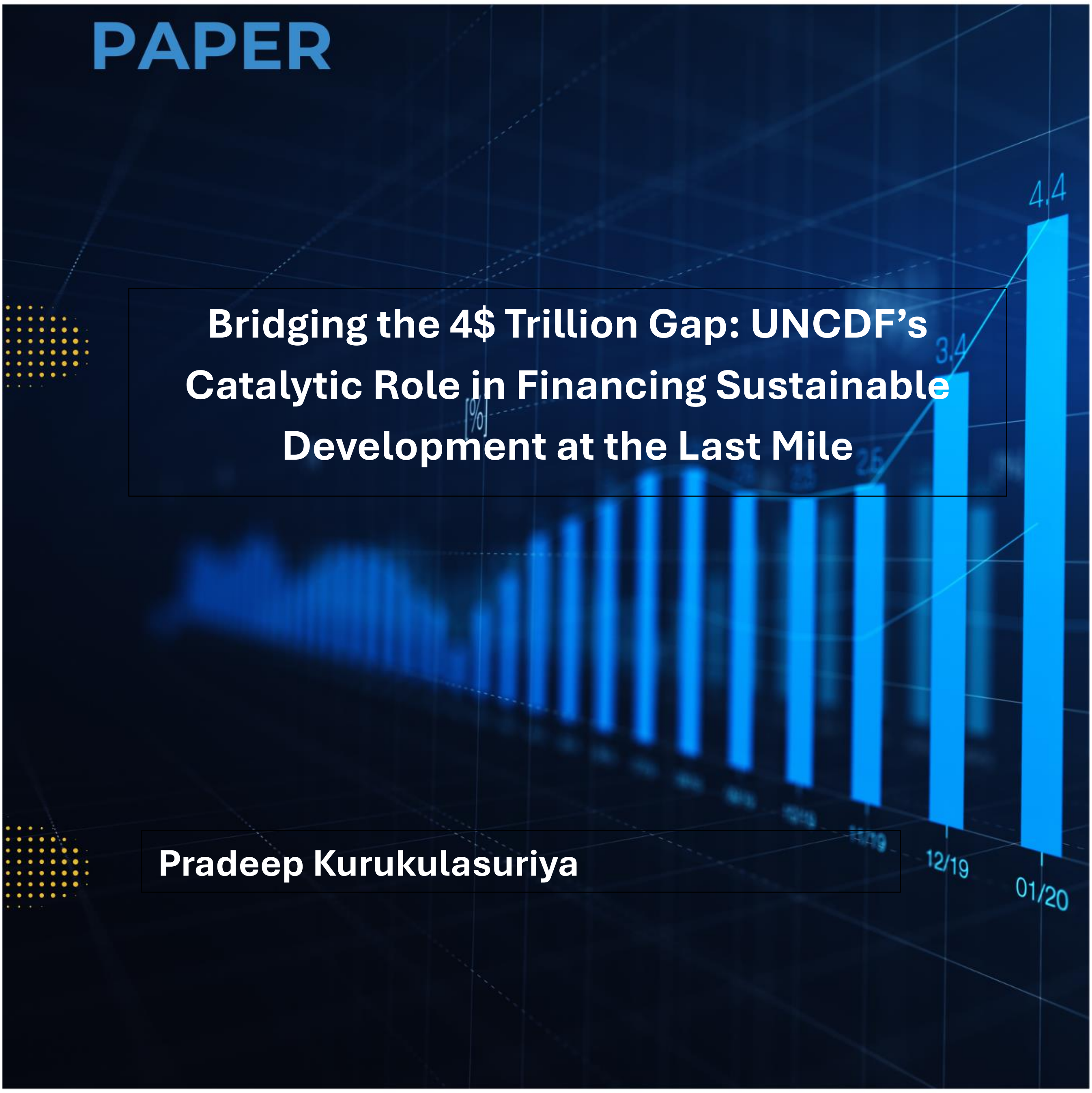

Bridging the 4$ Trillion Gap: UNCDF's Catalytic Role in Financing Sustainable Development at the Last Mile

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ABSTRACT

This paper explores the catalytic role of the United Nations Capital Development Fund (UNCDF) in addressing the $4 trillion financing gap for the Sustainable Development Goals (SDGs), particularly in the world's 46 Least Developed Countries (LDCs). It argues that traditional development finance institutions (DFIs) and grant-making bodies have failed to mobilize sufficient capital in high-risk, underserved markets due to structural limitations and risk aversion. UNCDF's unique positioning - non-credit rated, impact-driven, and flexible in capital deployment - enables it to operate in frontier markets where others cannot. Through instruments such as blended finance, local currency loans, guarantees, and performance-based payments, UNCDF demonstrates how targeted, concessional investments can unlock domestic capital, crowd in private finance, and build resilient financial ecosystems. Case studies from Tanzania, Afghanistan, Zimbabwe, Rwanda, and Peru illustrate UNCDF's market-creating function and its capacity to serve the "missing middle" in development finance. The paper concludes by advocating for a recalibration of global risk models and a scaling of UNCDF's approach to transform fiscal constraints into engines of inclusive and sustainable growth.

Keywords: Blended Finance, Development Finance Architecture, Least Developed Countries (LDCs), Catalytic Capital, Financial Inclusion and Resilience.

JEL Classification: F35, G23, O16, O19, Q01 and H81.

A critical crossroads in development finance

The global development community faces a paradoxical challenge.

In a world abundant with grant-making institutions funding high-impact but financially unviable projects on the one hand, and development finance institutions (DFIs) seeking risk-adjusted market returns on the other, we still confront a staggering $4 trillion financing gap in achieving the Sustainable Development Goals (SDGs) by 2030.

This disconnect raises a fundamental question: Why do we continue to fall short in mobilizing sufficient capital for sustainable development, particularly in the world's 46 Least Developed Countries (LDCs)?

When the groundwork for private capital to flow has yet to exist, these countries are seen by outside investors as too high risk, with markets too shallow, and financial ecosystems too fragile to absorb capital at scale — even concessional capital.

The United Nations Capital Development Fund (UNCDF) occupies a distinctive niche in this space. We are non-credit rated, not for profit, fully impact driven, and use donated resources as a funding model to deploy catalytic revolving investments.

This uniqueness gives us the ability to fill a critical gap in the financial ecosystem, with a higher risk appetite than Multilateral Development Banks and private impact financiers.

We were established in 1966 through a UN General Assembly Resolution with a clear mandate: To support developing countries in the development of their economies by supplementing existing sources of capital through grants and loans.

For decades, the potential of UNCDF has been underutilized in the UN Development System and the development finance infrastructure.

I came on board as UNCDF’s new Executive Secretary in 2024 with a mission to change this.

Following an organizational restructure designed to fully capitalize on our original mandate, UNCDF is re-pivoting its focus from an agency largely providing technical assistance to one that specializes in deploying derisking financial capital for early-stage investments in the world's most vulnerable countries.

We occupy a position that goes beyond the binary financing model that has long left frontier markets out in the cold. This disconnect leads us to the staggering development financing gap we have today.

The result of this binary is a "missing middle" in the financing landscape – where projects and enterprises are deemed too large for microfinance, but too small or risky for traditional commercial finance.

This gap is particularly evident in LDCs, where only 4-6 percent of private finance mobilized by Official Development Assistance (ODA) between 2012 and 2018 was directed[1].

The paradox becomes even more striking when we consider small- and medium-sized enterprises (SMEs), which have long been the backbone of developing economies. In 2022 these SMEs faced an estimated unmet credit need of $4.5 trillion in the developing world[2]. In LDCs, this financing gap is even more acute, with a higher percentage of firms identifying access to finance as a major constraint compared to other developing countries[3].

This article examines how UNCDF's distinctive approach to development finance can help transform the landscape of capital mobilization for sustainable development, channeling additional streams of finance to areas of the world that are underserved and where needs are greatest.

UNCDF's unique value proposition

One of the core features of UNCDF's value proposition is our ability to operate in areas of the world where traditional financing mechanisms have failed.

By deploying innovative blended finance instruments to higher-risk, often underserved regions and countries, UNCDF effectively 'de-risks'

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[1] https://www.oecd.org/content/dam/oecd/en/publications/reports/2020/12/blended-finance-in-the-least-developed-countries-2020_a314128d/57620d04-en.pdf
[2] https://www.ifc.org/en/insights-reports/2022/2022-global-sme-finance-facility-progress-report
[3] https://blendedfinancefordevelopment.com/

investments in these markets, helping to mobilize and catalyse future investments at scale.

This approach represents a paradigm shift from 'funding' development to 'financing development,' and by strategically deploying concessional capital, UNCDF works to create a multiplier effect that expands the impact of limited public resources, unlocking domestic capital and paving the way to wider investment.

With the combination of risk tolerance, capital deployment flexibility, and performance-focused investment, we have a distinctive and much-needed position for unlocking finance where needs are greatest.

Blended Finance: A catalyst for first- or last-mile solutions

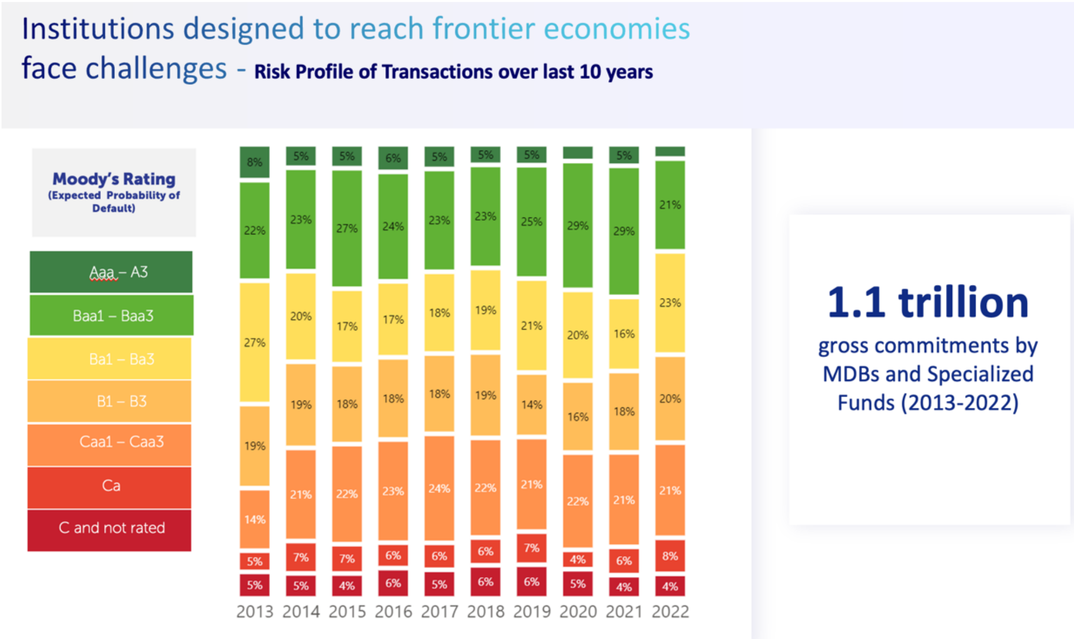
Blended finance has been a long-held solution which we need to pivot in order for it to work for private capital.

By combining public and philanthropic capital with private investment, blended finance has the potential to mitigate risks and incentivize private sector participation in high-risk markets. However, its success hinges on institutions capable of navigating complex financial landscapes, while maintaining a focus on outcomes. That has been easier said than done based on the track record at hand. The question is, why has that been the case?

I would argue that in fact, part of the reason is who is doing the de-risking matters. If the derisking is done by a credit-rated, highly regulated entity, then the underlying risk appetite is not going to be conducive to the realities of those early-stage markets. We see this today—one has to only unpack where investments are made against the risk profile of countries. The figure below makes it clear where financing from MDBs has actually gone in terms of the risk profile of the investments. Very few investments make it, understandably, to speculative markets.

Despite trillions in global finance, only a fraction reaches these countries (LDCs, and other last-mile contexts). Recent estimates by Convergence indicate that all of ODA has mobilized only 1% of private finance[4] for SDG and Climate Investment needs, with much of the mobilization from MDBs, Philanthropy and Foundations.

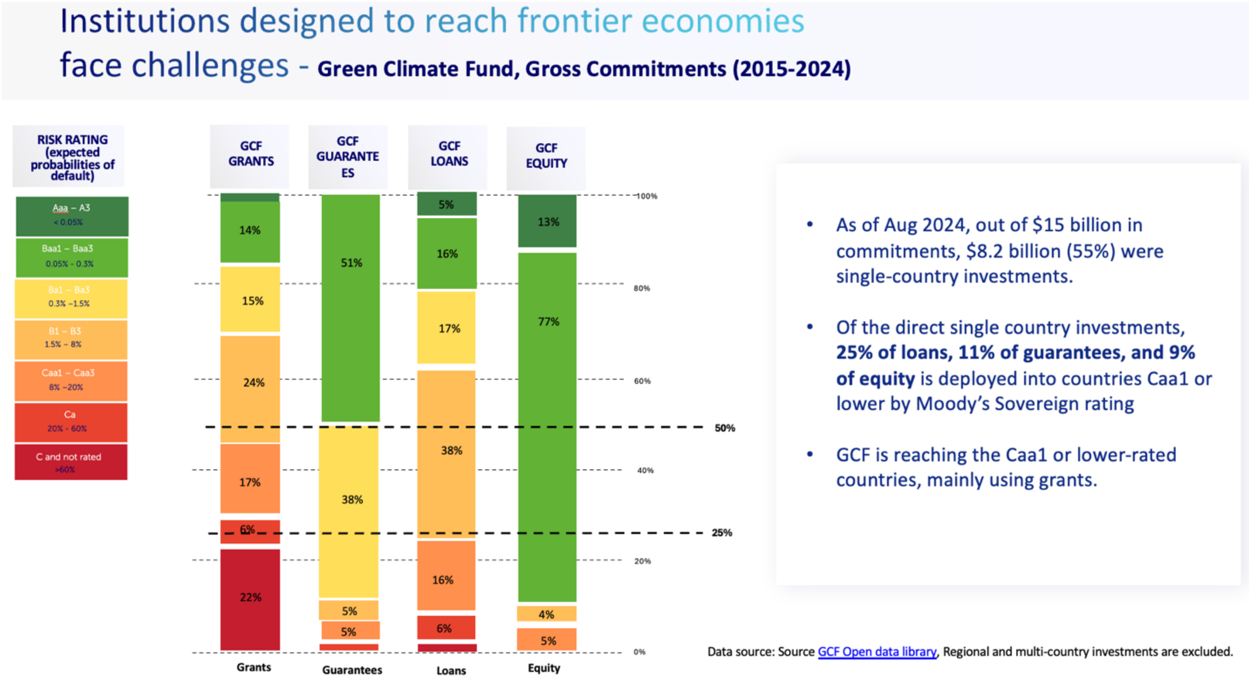
[4] https://www.convergence.finance/news/4FrZlC4gpudxrLZVqDTQmQ/view



Source: UNCDF 2025

Even those institutions that are designed to take on risks struggle, when highly risk friendly resources are deployed by credit rated institutions (by and large). As the graphic below shows using the Green Climate Fund (GCF) as an example, data from the GCF's data portal suggests that the amount dedicated to financing instruments that effectively crowd-in private sector capital remain limited in the context of high-risk markets.

While grant funding is significant, relying solely on grants to create markets is insufficient—we need to augment grants with the deployment of other financial instruments that can provide the financial derisking required to mobilize private investment. Derisking via institutions that are primarily pursuing financial objectives has not worked as well as we expect.



Source: UNCDF 2025

The critical factor here is being able to deploy blended instruments strategically at the first or last mile to maximize development impact – unlocking domestic capital, attracting private financing and, most importantly, sowing the seeds of market development that paves the way to systemic transformation.

For instance, performance-based payments ensure accountability and measurable impact; loans provide scalable solutions for infrastructure and enterprise development; and guarantees reduce risk for private investors entering unfamiliar markets.

These instruments not only unlock capital but also build resilience in communities facing multidimensional poverty and climate vulnerabilities.

There isn't enough of this type of support in today's development finance architecture and when it exists, underlying instruments are not structured with the required flexibility and consequently fail to have the desired effect of crowding in finance.

This is the *raison d'etre* for institutions such as the UN Capital Development Fund.

UNCDF was set up to take on exactly the above challenge via its instruments—modest in dollar terms compared to many of the larger DFIs—but with a risk appetite, flexibility, and, thus, ability to unlock disproportionately more impact. As I have stated before, this isn't about scale for scale's sake. It's about precision deployment: demonstrating viability where markets have failed or stalled.

The New Calculus of Development Finance

What happens when country risk profiles are too high, markets too shallow, and financial ecosystems too fragile to absorb capital at scale — even concessional capital?

UNCDF's concessional loans, guarantees and performance-based incentives, such as grants, including technical assistance to support local market development, are specifically tailored to the needs of LDCs, Small Island Developing States (SIDS), and fragile settings.

Being an unregistered entity enables us to overcome certain system constraints present in the traditional financial ecosystem, including credit ratings, capital adequacy ratios, and preferred creditor treatment requirements.

This unique risk appetite and ability to provide concessional capital to below investment grade-rated (C-category) countries is a strategic advantage that allows us to operate in spaces of high-need where private sector investment appetite is largely non-existent.

This capacity to take on higher risks positions allows us to support last-mile communities and underserved groups that would otherwise remain outside the reach of traditional finance. UNCDF's mandate allows us to demonstrate the viability of investments in these markets, creating a demonstration effect that can eventually attract commercial capital.

This model proved transformative in Tanzania, where a $1 million UNCDF investment catalyzed East Africa's first subnational Green Bond, raising $22 million (65% from domestic investors) for clean water infrastructure.

Unlocking domestic finance through East Africa’s first sub-national green bond (2023- 2034)

The Tanga Water Infrastructure Green Bond is groundbreaking initiative in Tanzania's efforts to develop its municipal and subnational bond market, alongside its broader strategic goal of diversifying revenue sources and mobilizing domestic resources for national development. Spearheaded by the UNCDF in partnership with the Government of Tanzania, the bond aims to broaden the country's revenue base by improving domestic resource mobilization.

Issued by the Tanga Urban Water Supply and Sanitation Authority (Tanga-UWASA) in February 2024, the green bond raised approximately $20.8 million in local currency, to finance the expansion and enhancement of the city's clean water infrastructure. This was a historic transaction, marking Tanzania’s first-ever subnational green bond and one of the first such bonds issued in Sub-Saharan Africa. The bond offered a 13.5% coupon rate and was listed on both the Dar es Salaam Stock Exchange and the Luxembourg Green Exchange, establishing a precedent for green investments in Tanzania. Notably, the bond was issued with no sovereign guarantee, which underscores the growing confidence in local capital markets and demonstrates the potential for local currency financing for infrastructure projects.

Leaving no-one behind: UNCDF and the ‘Missing Middle’

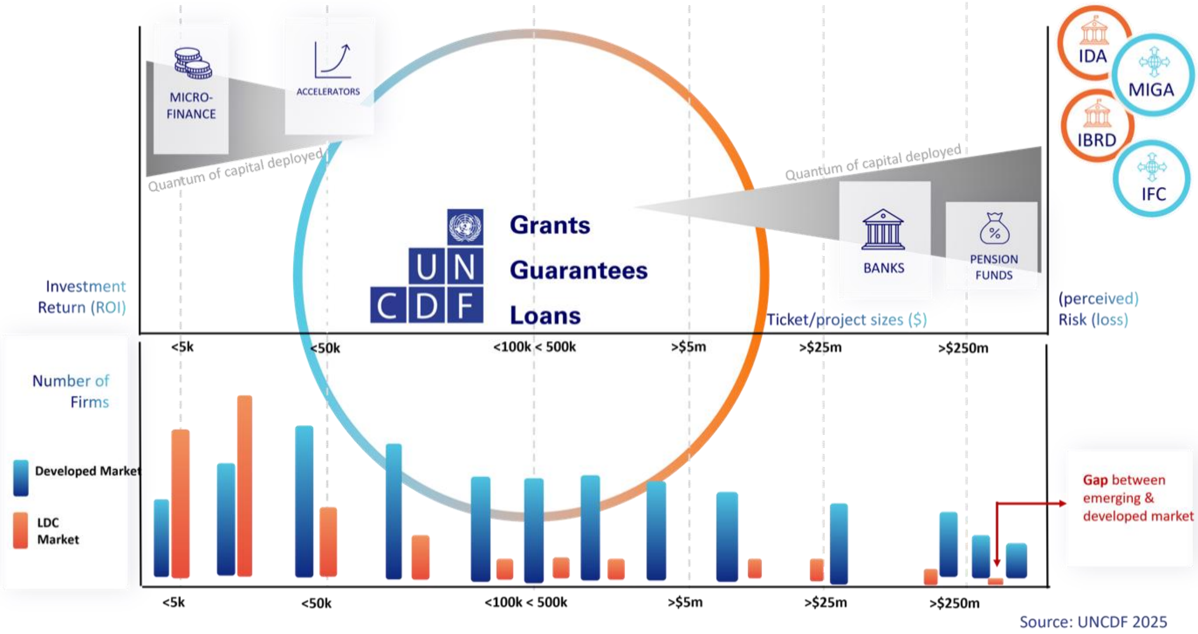
When I arrived last year at UNCDF, it was abundantly clear to me where we should be focusing our efforts – the so-called ‘missing middle’.

Currently, there are grant makers (public and private) that fund non-financially sustainable activities with high development impact, and there are impact investors (public and private) that majorly seek risk-adjusted market returns along with impact.

Herein lies the gap, which is particularly pronounced in LDCs.

To avoid the disconnect, adequately structured and revolving - repayable - capital, as UNCDF provides, can be particularly useful.

Serving the missing middle in last mile contexts



Source: UNCDF 2025

It's about the deployment of capital that is more than what microfinance provides, but below the typical $20 million floor for most regulated financial institutions.

In Afghanistan, arguably one of the most challenging environments in which to operate, UNCDF collaborated with our sister agency, the UN Development Programme (UNDP) and the Afghan Credit Guarantee Foundation to try to unlock $5.5 million in private capital for MSMEs — most of which would have never secured a loan without our $1 million guarantee facility. In a country where fewer than 3% of firms have access to formal credit, this could be a game-changer.

In Zimbabwe, with the backing of the Joint SDG Fund, we established an $8 million structured loan facility to anchor and launch the first national Renewable Energy Fund (REF) in Zimbabwe, managed by a local fund manager. With a targeted size of $50 million by the end of 2026, the REF will drive clean energy expansion, inclusive economic growth and job creation across Zimbabwe.

By reducing perceived investment risks and driving private finance flows into previously overlooked sectors, we assume a market-creating function that is a critical component to sustainable development outcomes in underserved countries, where market failures and information asymmetries often prevent the development of functional financial ecosystems.

The BRIDGE Facility: Filling the Missing Middle

The BRIDGE Facility represents one of UNCDF's flagship solutions for addressing the "missing middle" financing gap. By targeting investments between $100,000 and $1 million (and sometimes larger), BRIDGE provides crucial financing that enables projects to build track records and eventually become viable for commercial lenders.

What makes this approach particularly effective is that it addresses both sides of the financing equation: it improves returns to private investors who would otherwise not invest in these markets, while simultaneously facilitating affordable access to finance for end beneficiaries, supporting their transition to commercial finance over time1.

This distinctive approach to the missing middle is especially valuable because it targets the critical middle segment where sustainable economic growth and job creation often occur. By focusing on enterprises and projects that are too large for microfinance but too small for traditional DFIs, UNCDF helps build more complete and inclusive financial ecosystems in LDCs.

For example, in Rwanda, UNCDF, WFP and the Mastercard Foundation provided a $500,000 partial credit guarantee to Urwego Finance, a local financial services provider, covering 70 per cent of potential losses. This paved the way for Urwego to extend direct loans to micro, small and medium-sized businesses in the agricultural sector, many of which are often excluded due to the lack of tangible collateral and perceived high risk.

Without this guarantee, these businesses faced collateral requirements as high as 130 per cent to 150 per cent of the loans’ value, an unattainable threshold for most. The guarantee lowered barriers and helped to provide access to financing for the investment needs and working capital.

The power of local currency solutions

A critical dimension of UNCDF's approach is its commitment to local currency financing. In developing countries, particularly LDCs and SIDS, currency risk represents an existential threat to sustainable development.

When foreign capital fund domestic investments, exchange rate fluctuations can devastate borrowers' balance sheets and ultimately lead to default.

Traditional DFIs typically lend in foreign currencies, creating significant currency mismatches that undermine long-term project viability[5]. Borrowers often opt for deceptively "cheaper" foreign currency loans despite their greater long-term risks, driven by short-term budgetary pressures and political cycles[6].

Mobilizing and catalysing finance for underserved markets

UNCDF and Nilus, a food services technology company, entered into a partnership with WFP in Peru to reach more than 150,000 underserved people with healthy food through 2,500 community kitchens, government-supported canteens and restaurants that will serve low-income communities in Lima by 2028.

Under this initiative, UNDCF approved a local currency loan to Nilus, which will be disbursed in 2025. This investment is expected to leverage more than two times the amount in additional capital from private investors. The investee leverages digital logistics technology and a mobile e-commerce app to reduce the cost of accessing healthy food by consolidating orders from low-income people. An earlier pilot phase demonstrated that the company helped underserved populations to save approximately 24 per cent on food costs and 6 per cent on transportation.

UNCDF addresses this fundamental market failure by providing financing in local currencies when needed. This approach reduces currency risk for borrowers, increases project sustainability, and helps develop local capital markets. For SIDS and LDCs especially, where currency volatility can be

[5] https://www.iisd.org/system/files/publications/currency-risk-project-finance-discussion-paper.pdf
[6] Ibid.

extreme and hedging mechanisms limited or non-existent, local currency financing represents a critical tool for building economic resilience.

Unlocking Finance Through Guarantee Mechanisms

UNCDF's guarantee mechanisms serve as powerful catalysts to unlock additional streams of finance in underserved and high-risk markets.

These instruments work by reducing the perceived and real risks associated with lending to underserved groups, incentivizing financial institutions to extend credit where they otherwise would not.

Building local economies, creating jobs

As part of a strategic collaboration with UNICEF, UNCDF closed its first child-lens investment with a $2.5 million USD loan to Nigerian company Ariel Foods FZE, which specializes in producing lifesaving Ready to Use Therapeutic Food to help combat childhood malnutrition.

This investment is being used to finance specialized on-site processing equipment for peanuts and other legumes. The investment not only empowers local farmers with new, sustainable offtake revenue, but also reduces reliance on imports, builds resilience in local and global supply chains, and puts African-grown produce at the center of the fight against childhood malnutrition.

This guarantee is a demonstration of how the UN Capital Development Fund's investment capabilities can advance and complement the work of the wider UN development system, support the local private sector, and build a more inclusive and sustainable development finance ecosystem.

The Path Forward: Scaling Impact in a Resource-Constrained World

Despite recent reductions in ODA, the need for development finance has never been greater.

The challenge – and indeed opportunity – we now face is to scale innovative approaches to match the magnitude of the development financing gap, while at the same time operating in a more constrained resource environment.

Countries bearing the brunt of global climate adaptation costs often face borrowing costs sometimes close to eight times higher than advanced economies. This is not due to their own fiscal mismanagement, but because rating agencies assess climate risks as permanent fiscal burdens, leading to lower credit ratings and higher interest rates for these countries

Even before the recent surge in interest rates, LDCs that borrow from international capital markets faced rates of up to 8 percent compared to 1 percent in wealthier countries. When it comes to climate finance, this can translate into heavy costs beyond what climate action already requires. In 2019-2020, over 60 percent of climate finance entailed borrowing funds, or around $384 billion[7]. Only $47 billion came with low cost or concessional interest rates. No-cost grant finance was only $36 billion[8].

The over-indebtedness of these countries translates into them not wanting more sovereign lending, but instead for foreign direct investment and capital to go directly into their private sectors.

UNCDF's work proves that the "high risk" label applied to LDCs, SIDS and others reflects flawed financial models, not inherent insolvency.

We at UNCDF are going to make it a point to enter ecosystems before the enabling environment is bankable, using catalytic concessional first-loss capital to reduce risk and crowd-in investments.

By recalibrating risk algorithms that help drive finance to high-risk markets, we can place value on the capital of community resilience, indigenous adaptation knowledge, and circular economy potential. We build the needed scaffolding in markets too often overlooked, helping investors eventually say “yes” to places where they would otherwise pass.

In that sense, UNCDF is not a competitor of the traditional financial sector—we are essentially their advance off-balance sheet derisking team.

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[7]https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/

[8]https://www.un.org/en/climatechange/raising-ambition/climate-finance#:~:text=High%20financing%20costs%20largely%20drive,in%20private%2Dsector%20green%20investments.

The message to global investors is clear: In the calculus of 21st Century development, there are no high-risk countries – only outdated risk models.

UNCDF's financial innovation is rewriting the equation, and in doing so, offering a critical pathway to sustainable development in a more challenging global landscape.

Conclusion: Financing the possible in impossible markets

The $4 trillion financing gap for the SDGs isn't merely a liability; it's the world's largest untapped impact investment opportunity.

In a world where private capital only flows to where confidence exists, UNCDF helps create that confidence.

This UNCDF blueprint—combining catalytic capital, the ability to recalibrate risk, and the convening power of the UN and its deep local partnerships—offers actionable solutions for policymakers, UN agencies and the private sector ahead of the 4th International Conference on Financing for Development this June.

In an era of constrained public resources and geopolitical uncertainty, the imperative to rethink development finance has never been clearer. By leveraging and scaling UNCDF's proven solutions, the international community has the opportunity to transform today's fiscal constraints into engines of inclusive and sustainable economic growth.

While the traditional regulated and credit-rated DFIs strengthen the highway, UNCDF builds the first (or last) mile.

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