

OPINION ARTICLE

Blended Finance | Fragile States

The Invisible Billion

BY NOVANTUM ADVISORY GROUP

By 2040, 92 percent of the world's extreme poor will live in fragile and conflict-affected states. International aid is falling. Private capital barely reaches these places. And yet the market is systematically mispricing the risk of investing there, proven by 30 years of hard data. This is not a charity problem. It is a market design failure with a known fix.

There is a number that should be on the front page of every financial publication in the world. By 2040, an estimated 92 percent of the world's extreme poor will live in fragile and conflict-affected states¹. One projection. Ninety-two percent. That is the invisible billion, the people the international financing system has largely chosen not to engage with, concentrated in the places it has largely chosen not to go.

Not a majority. Not a plurality. Ninety-two percent.

And yet, aid flows to these contexts are falling. Private capital barely reaches them. The institutions designed to bridge the gap are chronically under-resourced and, in many cases, using the wrong tools.

The standard explanation is risk. Fragile states are dangerous, unstable, ungoverned. Investors lose money there. The returns do not justify the exposure. Better to deploy capital in places where the fundamentals are cleaner and the exits are clearer.

There is one problem with this explanation. It is not supported by the data.

THE MARKET IS MISPRICING RISK

In 2024, the Global Emerging Markets Risk Database compiled from approximately 15,000 loans made by 26 multilateral development banks and development finance institutions over 30 years was opened to the public for the first time. What it showed was striking².

6.3%

Actual average default rate in low-income countries (GEMs, 2024) · Sovereign ratings imply 14.2%

6.3 percent of average default rate in low-income countries. The rate implied by sovereign credit ratings is 14.2 percent. Recovery rates on loans that did default averaged 72 percent, comparable to global benchmarks for mainstream lending².

The market is not pricing risk. It is pricing ignorance.

When investors cannot measure something accurately, they do not price it carefully. They price it fearfully. The result is a gap between perceived and actual risk that is nearly eight percentage points wide and that gap is costing the world's poorest people the investment they need.

This is not a charity problem. It is a market design failure. And market design failures have known fixes.

WHAT THE GAP ACTUALLY LOOKS LIKE

The 61 contexts identified by the OECD as experiencing high or extreme fragility are home to 2.1 billion people, which is one quarter of the global population and 72 percent of the world's extreme poor¹. These are not peripheral economies. They are the places where the next generation of global poverty will be concentrated.

Official development assistance, the international aid system's primary instrument for reaching these contexts peaked at USD 103.5 billion in 2020 and has since declined to USD 93.1 billion in 2023. The share of donor aid directed to the most fragile states has fallen to its lowest level in two decades. Peace-related ODA fell 29 percent between 2019 and 2023, reaching its second-lowest level since 2004.³ Meanwhile, less than 5 percent of global net foreign direct investment reaches fragile contexts at all.

Private capital has not compensated for aid's retreat. It has largely gone elsewhere.

The consequence is a self-reinforcing cycle. Low capital flows reduce economic activity. Reduced economic activity weakens institutions. Weakened institutions generate the instability that investors cite as justification for non-investment. And the cycle continues.

A TOOL THAT WORKS IF DEPLOYED AT AN INADEQUATE SCALE

The cycle described above is not unbreakable. There is a category of instrument of blended finance, in which concessional public capital absorbs first losses and crowds in private investment that is specifically designed to correct the risk mispricing that sustains it. And there is a growing body of evidence that when it is properly structured, it works.

The IDA Private Sector Window, operated by the World Bank Group, has committed USD 5.4 billion in concessional capital and mobilised over USD 31 billion in total investment since its inception⁵. It made IFC's first agribusiness investment in Yemen possible during active armed conflict. It unlocked solar energy investment in the DRC. It has demonstrated, transaction by transaction, that commercial capital can reach places the market has written off when the instrument design transfers the right risks to the parties best positioned to absorb them.

And yet, across the entire fragile state blended finance universe, only 54 transactions were recorded between 2019 and 2023, totalling USD 4.5 billion⁴. That is not a market. That is a proof of concept that has not been scaled.

The most rigorous available economic modelling commissioned for the World Bank and UN's Pathways for Peace study estimates that a functioning conflict prevention and stabilisation system targeting roughly five high-risk countries per year could prevent an average of USD 33 billion per year in net economic losses⁶. The cost of inaction is not abstract. It is measurable.

THE ARCHITECTURE ARGUMENT

The instruments exist. The evidence points toward what works. What has been missing is the institutional will to deploy them at the scale the problem demands.

This is not an argument for charity. It is an argument for correcting a market failure. The data shows that the risk is lower than investors believe. The case studies show that properly structured instruments can mobilise commercial capital even in active conflict zones. The macroeconomic evidence shows that the cost of continued non-investment is orders of magnitude larger than the cost of getting the instrument design right.

Fragile states are not inherently uninvestable. They are inadequately de-risked.

By 2040, 92 percent of the world's extreme poor will be concentrated in the contexts the international financing system has spent the last three decades treating as residual categories too risky for capital, too complex for aid cycles, too distant from commercial returns for serious institutional attention.

The question is no longer whether we have the tools to change this. We do. The question is whether the actors with the resources, the mandates, and the analytical capacity to act will choose to treat the invisible billion as the financing problem it actually is rather than the charity case it is not.

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