Building Block 1 Assessment and Diagnostics: Overview

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1. Introduction
Every vision needs a plan, every plan a budget and every budget an estimate of costs. To this end, the assessments and diagnostics phase of an integrated national financing framework (INFF) provides for a detailed understanding of financing gaps for national priorities and the SDGs, and of challenges, risks and opportunities in a country’s financing landscape.

This guidance material on the assessments and diagnostics building block of an INFF consists of five elements:

- this Overview note; and four detailed guidance notes on:
- financing needs assessment (BB1.1);
- financing landscape assessment (BB1.2);
- risk assessment (BB1.3); and
- binding constraints diagnostic (BB1.4).

It builds on the INFF inception phase guidance, which lays out how countries can initiate an INFF process, institutionalise key oversight structures, undertake scoping and articulate an INFF roadmap. Depending on country preferences and needs, assessments and diagnostics may either be undertaken as part of the INFF inception phase, to inform a more detailed INFF roadmap (facilitated, in many cases, by Development Finance Assessments), or after the inception phase.

The assessment and diagnostics guidance lays out value, scope, lessons learned, and practical ‘how to’ considerations for each of the four main elements. It presents a range of assessment and diagnostics tools and approaches that countries can use to complement ongoing national efforts and provides examples and case studies of how different countries have undertaken such assessments in different contexts.

1 See INFF Inception Phase Guidance here: https://inff.org/inff-building-blocks/inception-phase
National and local government officials are the main audience for this material, but it should also be useful for international development partners and other stakeholders supporting governments in their efforts.

2. What is different about INFF assessments and diagnostics

In line with the overall INFF approach, assessment and diagnostics will not start from scratch. Rather, insights and knowledge from relevant stakeholders are brought together, and existing systems, processes and tools used in support of a nationally owned process. In this light, INFF assessments and diagnostics are:

- **Comprehensive** – supporting consideration of all sources of finance (public, private, domestic, international) as well as global norms and systems, and uses public policy to leverage their contributions.

- **Integrated** – providing a common foundation to discuss and prioritise spending and investment decisions and policies across different sectors, and to enable a more effective and synergistic use of resources (both public and private), mindful of the trade-offs that may exist in the pursuit of all dimensions of sustainable development.

- **Iterative** – enhancing capacity to maintain a current understanding of the financing and risk landscapes and facilitating adjustments of financing policies when conditions change.

- **Inclusive** – engaging diverse stakeholders in a meaningful and equitable manner to better reflect the country’s financing needs, challenges and opportunities and to mainstream cross-cutting priorities such as gender equality.

3. The role of assessments and diagnostics within an INFF

The assessments and diagnostics building block paints a picture of the demand and supply sides of financing, assesses how the ability to finance sustainable development outcomes may be affected by economic and non-economic shocks and crises, and identifies key bottlenecks that hinder effective mobilisation and alignment of resources.

Assessments of **financing needs** and of trends in the current **financing landscape** create a baseline understanding of financing gaps. They help identify areas where financing policy action may be required. **Risk** assessments identify major risks to sustainable financing and policy action to strengthen resilience. **Binding constraints** diagnostics identify the underlying economic, institutional, capacity and policy impediments, which helps in policy prioritisation and sequencing, building a bridge to the financing strategy.

As shown in Figure 1, the four elements of the assessment and diagnostics building block are highly interconnected, and need not be considered in sequence. Ideally, assessments are undertaken in an iterative manner, so that findings from the risk assessment, for example, also inform financing needs assessments. Together, they provide the necessary evidence to identify priority areas for policy action to be addressed in the financing strategy (building block 2), as well as a robust baseline to inform the design and implementation of adequate monitoring and review systems (building block 3) and governance and coordination mechanisms (building block 4).
4. Assessments and diagnostics in practice

Across all four components (financing needs, financing landscape, risks, and binding constraints), the guidance encourages both a ‘top-down’ and ‘bottom-up’ approach.

The former includes a review of existing assessments and diagnostics, and provides a range of tools and methodologies that countries can draw on to undertake additional exercises deemed necessary.

The latter consists of consultations and dialogue with all relevant stakeholders, to ensure that insights and lessons learned from implementation experiences and practitioners are taken into account. For example, in relation to financing needs assessments, consultations with project implementers may inform the choice of methodology and resulting estimates, based on typical challenges they face. Non-state actors may be able to help close data gaps.
(e.g. for domestic private investment and private non-commercial financing such as philanthropy and voluntary giving) and complete financing landscape assessments. In the risk assessment, stakeholders can shed light on differences in exposure and vulnerability by population groups (as this may not always be visible in available data or existing assessments). Stakeholders from both within and outside government can also validate constraints identified in the binding constraints diagnostic.

Sections 4.1-4.4 below summarize the detailed guidance materials for each of the components in brief. Detailed guidance includes a suggested step-by-step approach that government officials and INFF oversight teams can adopt and adapt depending on specific country needs and contexts.

4.1 Financing needs assessment in brief

The financing needs assessment aims to estimate the financial resources required to implement national sustainable development priorities (through quantitative costing) and to support the identification of possible financing options (through qualitative considerations). It also aims to support decision-making around the utility of costing exercises at different levels and for different purposes.²

The type and scope of costing exercises required will depend on where a country is in the planning cycle (e.g. development of national development plan or articulation of specific projects and programmes within individual sectors); its needs (e.g. short- or longer-term estimates of cost); and available capacity (in terms of time, financial and human resources) (see Figure 1).

Figure 1. The scope of financing needs assessments depends on what countries wish to cost

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² See Table 1 in detailed BB1.1 Financing Needs Assessment guidance.
The choice of methodology will also depend on the function of the costing exercise (see Figure 2) and will in turn support the identification of the most relevant tools that may support national actors.\(^3\)

**Figure 2. How to choose the most appropriate costing methodology**

**Is a financing needs assessment required?**

- **No**
  - **Operational planning and budgeting (short/medium-term)**
    - **Bottom-up unit cost approaches**
      - **Best for:**
        - In-depth, detailed costing exercises where unit costs of individual inputs or interventions are known
  - **Historical trends approaches**
    - **Best for:**
      - Estimating financing needs for continuing existing programmes and interventions, based on past cost

- **Yes**
  - **Strategic planning and target setting (long-term)**
    - **Top-down unit cost approaches**
      - **Best for:**
        - Benchmarking financing needs based on cost in good performing peer countries or estimating financing needs based on proxy unit costs for given inputs of interventions
    - **Model-based approaches**
      - **Best for:**
        - High-level estimates of cost under different policy scenarios or based on growth projections or general/partial equilibrium models

Three key issues must be considered in calculating cost estimates:

- **Flexible scenarios and risk.** Growth shocks, disasters, and other events outside a country’s control, as well as changes in policy direction and priorities can impact cost estimates. Policy simulation tools can help, and findings from the risk assessment (see section 4.3) provide valuable insight into the potential financial consequences of major risks the country faces.
- **Sustainability.** All dimensions of sustainable development should be taken into account. The principle of leaving no one behind underpins the SDGs and should guide the articulation of interventions and policies to be costed. The UN framework for assessing who is being left behind can support the identification of most-at-risk

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\(^3\) See Table 4 in detailed BB1.1 Financing Needs Assessment guidance.
populations and inform revisions to cost estimates accordingly (see Figure 4 in full BB1.1 guidance). Environmental and climate change considerations should be incorporated, ensuring that green options are taken into account when costing actions needed to achieve priority outcomes.

- **Synergies.** Harnessing synergies can reduce total financing needs and maximise the impact of investments. Several costing tools offer support in minimising duplication and maximising efficiencies across and within sectors and outcome areas. Dynamic modelling and network analysis tools can help to identify which policies or interventions would have the largest spill-over effects, and support prioritisation and focusing of costing efforts where this may be required.

### 4.2 Financing landscape assessment in brief

The financing landscape assessment aims to provide a comprehensive picture of the country’s financing trends, challenges and opportunities – looking across the full range of resources included in the Addis Ababa Action Agenda (domestic, international, public and private).

Both the quantity and quality of financing matter – financing volumes and alignment with national development priorities should be assessed. The landscape assessment consists of two main levels of analysis:

- an **aggregate assessment of the financing landscape**: scale and mix of current spending and investment; how sustainable it is; major trends; how the landscape may evolve in the future; where additional finance could be mobilised or where more efficient and effective use of existing resources could be made.

- an **analysis of allocation and use** of financing, and of the links between financing and desired sustainable development outcomes. This includes sector-specific analysis, and assessment of financing for cross-cutting priorities such as gender or climate.

Both rely mainly of nationally produced data (including national accounting and government budget data), with which government officials are already familiar, and on complementary sources of data where needed. Together, they define the baseline for assessing financing gaps.

Figure 3 provides an illustrative snapshot of an aggregate assessment. It includes a panel on the sources and levels of government expenditure (public finance); a macro-focused panel on savings and investment levels; and two panels related to the sources and levels of private financing to fund investment.
Figure 3. Aggregate financing landscape: an illustration using data for Mexico

Disaggregated analysis looks at spending or investment in different sectors or in support of cross-cutting thematic priorities, such as gender, climate action or disaster risk reduction. Programme or performance-based monitoring tools, such as public expenditure tagging systems, SDG budgeting frameworks and risk-informed budget reviews, can be useful sources of data and information. In some countries, initiatives focused on monitoring the contribution of private sector actors to sustainable development outcomes may also exist. In addition, data on both public and private finance may be disaggregated by sector and sub-national locations to shed light on how different priorities and areas are being resourced and to provide a baseline for calculating financing gaps beyond the most aggregate level.

In addition to informing the estimation of financing gaps, the financing landscape assessment can provide insight into the required scope and focus of risk assessments (e.g. if specific types of finance dominate the landscape). They can flag key challenges to the effective use of resources and identify opportunities that can directly inform the articulation of the financing strategy.

4.3 Risk assessment in brief
Shocks, crises and disasters can destabilise mobilization and allocation of financing for sustainable development, increasing financing gaps and ultimately undermining sustainable development progress. In the context of INFFs, the ‘system at risk’ involves the institutions, mechanisms and actors that mobilise, allocate, spend or invest financial resources. The aim of the risk assessment is to strengthen governments’ understanding of risks to sustainable development financing, and to support the design of risk-informed financing strategies. As the COVID-19 pandemic has further underlined, financing strategies that do not consider the impact of potential shocks and disasters cannot be sustainable.
The scope and focus of INFF risk assessments will depend on country contexts, but both economic and non-economic risks (such as disasters and pandemics), should be considered when mapping the risk landscape. At the core of INFF risk assessments is the analysis of their impact on the country’s financing system, with a view to avoid or reduce future disruptions. It also helps to prioritise which risks should be the focus of policy action.

Analysis of different types of risks may be brought together using the template illustrated in Table 1, which not only identifies relevant risks, but also assesses their impact on financing.

**Table 1. Template for mapping the potential impact of identified risks on a country’s financing system**

<table>
<thead>
<tr>
<th>Relevant risks</th>
<th>Impact on country’s financing system</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>List high probability/ high impact risks identified above (and for each identify impact, based on questions set out in columns to the right)</td>
<td>Describe elements of the financing system impacted directly by the shock/ risk event – e.g.</td>
<td>Describe elements of the financing system impacted indirectly by the shock/ risk event, or as a result of its cascading effects – e.g.</td>
</tr>
<tr>
<td></td>
<td>• Would the shock result in immediate calls for public finance to deal with the response?</td>
<td>• Would the shock result in (additional) fiscal and/or financial shocks?</td>
</tr>
<tr>
<td></td>
<td>• Would different population groups be differently affected by the shock, e.g. women and men?</td>
<td>• Would the shock result in a need for subsidies by the state/ fiscal transfers/ tax reductions, additional to the cost of initial emergency responses and recovery support?</td>
</tr>
<tr>
<td></td>
<td>• Would specific segments of the population require additional government support? If so, which ones?</td>
<td>• Would such need be exacerbated by different exposure and vulnerability levels of different segments of the population?</td>
</tr>
<tr>
<td></td>
<td>• Would the shock result in immediate restrictions and/or increased cost to access private or external sources of finance?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Which actors would be particularly hit by the shock? (e.g. private businesses/ banks/ households/ etc.)</td>
<td></td>
</tr>
</tbody>
</table>

To address remaining areas of vulnerability and build resilience, policies in three broad categories are highlighted:

- Those that reduce the **likelihood** of shocks occurring and of hazards turning into disasters, such as measures that address underlying risk drivers and avoid the creation of new risk;
- Those that reduce the negative and cascading **consequences** of shocks and hazards when they occur, such as preparedness measures that support countries to more effectively anticipate, respond and recover from shocks and disasters;
- Those that help to manage or transfer **residual risk**, including measures that ensure the system retains critical abilities during a shock or disaster and can recover afterward.

Depending on the nature of the risk,\(^4\) domestic efforts may or may not suffice to adequately address it. For example, domestic action may be enough to manage and reduce the

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\(^4\) See section 3 in detailed BB1.3 Risk Assessment guidance.
negative consequences of exogenous shocks and crises, but will not prevent them; coordinated global action will generally be required. Conversely, shocks emanating from within the system at risk can often be prevented, or their likelihood reduced, domestically. Risk assessments undertaken in the context of INFFs can inform domestic policy solutions as well as asks of development partners and global policy processes, with a view to strengthen development cooperation and create a more enabling international environment (see Figure 4).

**Figure 4. Decision tree to guide the identification of possible policy solutions**

```plaintext
Can the likelihood of the risk materializing be reduced?

YES

Are there any gaps in the policies currently in place to prevent or reduce the likelihood of possible risk events?

YES

Are identified solutions feasible and cost-effective?

YES

BB2 (financing strategy)

NO

NO

NO

Articulate policy asks of development partners and of global policy processes

NO

Can the impact/ cost resulting from the risk materializing be reduced?

YES

NO

Can the residual risk be managed or transferred?

YES

NO

Are there any gaps in the policies currently in place to reduce the impact/ cost of possible risk events?

YES

NO

Are there any gaps in the policies currently in place to respond to, or transfer the residual risk?

YES

NO

No further action
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**4.4 Binding constraints diagnostic in brief**

The binding constraints diagnostic builds on findings from the other three components of BB1. It deepens the analysis of impediments hindering effective mobilisation and use of financing for sustainable development, and their root causes. The aim is to guide the identification of those constraints that, if removed, would have the greatest impact on the country’s ability to finance sustainable development (i.e. the binding constraints). Findings can guide prioritisation of policy reforms and action and, along with key financing opportunities identified in the financing landscape analysis, can help shape the focus of the financing strategy.
The suggested approach for binding constraints analysis draws on the expertise and experience of local stakeholders and practitioners, complemented by relevant analytical tools (see Table 2 in full BB1.4 guidance for a list of such tools). It provides structure to a process that policymakers undertake on a daily basis (constraint assessment), and in so doing facilitates a more systematic approach that can help unearth constraints that would otherwise go undetected.

The methodology consists of three steps:

- Identifying key problem areas;
- Identifying underlying binding constraints; and
- Prioritizing constraints to address in a financing strategy.

Findings from the other three assessment and diagnostics exercises can provide a useful starting point to identify problem areas, as can contextual knowledge and experience of relevant stakeholders and experts, and other existing assessments. Governments may also refer to a mapping of existing financing policies and institutions, which may have been undertaken as part of the INFF inception phase and can reveal potential gaps and weaknesses in the existing financing policy and institutional landscape.

To identify binding constraints (step 2), an iterative process explores underlying constraints in each identified problem area. The approach is inspired by the growth diagnostics methodology (see Figure 5), which at its core seeks to identify a small set of key market-related, institutional, policy and/or capacity-related obstacles to investment in specific national contexts. In light of the broader scope of INFFs, the problem-driven, decision-tree method of growth diagnostics is modified to apply to the broader objectives of financing for sustainable development.

Local knowledge and evidence from existing assessments (such as findings from IMF technical assistance reports, Investment Policy Reviews, Enterprise Surveys, Public Expenditure and Financial Accountability assessments, among others) allow for an initial mapping of plausible constraints. Through a series of ‘why’ questions, a ‘short list’ of possible underlying causes, or in other words, binding constraints, can be identified. To identify the most binding constraint, insights and experiences of local stakeholders and experts can help to check whether constraints exhibit certain properties (e.g. whether actors invest resources to overcome the constraint, or whether its lifting had significant impacts) that would signify their binding nature (see section 4.2 in full BB1.4 guidance).
Figure 5. Growth diagnostics decision tree

Source: Source: Hausmann, R., Rodrik, D. & Velasco, A., 2005
No government will be able to address all identified binding constraints. Additional factors can support further prioritisation and sequencing. These include first and foremost the need to ensure coherence with sustainable development outcomes and thus to assess the impact that removing a constraint would have on all dimensions of sustainability (e.g. important environmental or labour market regulations may constrain investment but removing them would have negative consequences on social and environmental outcomes). Other factors include the level of political will required to implement possible solutions; the extent to which lifting a constraint would have positive effects across multiple financing areas or sectors; and timing of impact and ease of remediation (e.g. prioritising ‘quick fixes’ and building on such successes to address longer-term and more complex issues).

4.5 Entry points: relevant processes and stakeholders
Countries typically carry out assessments and diagnostics as part of existing policy and planning processes. These can be used to identify how assessments and diagnostics in the context of INFFs may be carried out most effectively, making use of existing systems, knowledge and tools. Table 2 summarises what these processes tend to be, which may be used as entry points for INFF assessments and diagnostics at the country level. It also provides an overview of stakeholders that would typically be involved.
Table 2. Relevant processes and stakeholders for INFF assessments and diagnostics

<table>
<thead>
<tr>
<th>Assessment and diagnostics components</th>
<th>Relevant processes/ entry points</th>
<th>Relevant stakeholders to be consulted/ involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>BB1.1 Financing needs assessment</td>
<td>• Annual budget processes, including decentralised budgeting; • Development of new or updated national development plans or sectoral/ thematic plans; • Investment requirements for risk reduction; • Introduction of new legislation; • Citizen participation initiatives; • Development partners engagement processes</td>
<td>• Ministries of Planning; Ministries of Finance; Central Banks; line Ministries (e.g. for sector-specific costings); regional and local governments (e.g. for sub-national level costings); Parliamentary committees and budget offices • Civil society, including women’s organisations; local communities; NGOs; think tanks • Private sector entities (e.g. for costings related to projects that require private finance participation) • Development partners, especially those who have developed specific costing tools or methodologies (such as the IMF, UN ESCAP and UNDP) and/or with sectoral expertise related to costings • National and other public development banks • Regional inter-governmental organisations, with a mandate in development assistance</td>
</tr>
<tr>
<td>BB1.2 Financing landscape assessment</td>
<td>• Development of national development plans or SDG implementation plans; • Annual budget processes (especially relevant for analysis of public finance trends across government and the public sector); • Policy processes related to the governance of specific financing or to financing for specific priorities (such as strategies for economic or industrial development, infrastructure planning, MSME development, financial inclusion or financial sector deepening, gender responsive budgeting, sectoral or thematic issues, including disaster risk reduction financing); • International public and private financing flows assessments</td>
<td>• Ministries of Finance; Ministries of Planning; Central Banks; National Statistical Bureaus; line ministries (e.g. those with mandates closely related to financing issues, such as Foreign Affairs Ministries in relation to development cooperation); Parliamentary committees and budget offices; other government agencies with specific sectoral knowledge or expertise • Civil society, including women’s organisations; NGOs; think tanks • Private sector actors including major investors, industry associations and chambers of commerce • Development partners who have developed tools and methodologies for mapping and analysing</td>
</tr>
<tr>
<td>Assessment and diagnostics components</td>
<td>Relevant processes/ entry points</td>
<td>Relevant stakeholders to be consulted/ involved</td>
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<td>------------------------------------------------</td>
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<tr>
<td>BB1.3 Risk assessment</td>
<td>• National development plans;</td>
<td>• Ministries of Finance; Central Banks; financial</td>
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<tr>
<td></td>
<td>• Macroeconomic/macroprudential</td>
<td>market regulators; national climate change and</td>
</tr>
<tr>
<td></td>
<td>policies;</td>
<td>disaster risk management authorities/institutions;</td>
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<td></td>
<td>• Legislative, regulatory or</td>
<td>Parliamentary committees</td>
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<td></td>
<td>policy frameworks, for specific</td>
<td>• Civil society, including NGOs and think tanks,</td>
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<td></td>
<td>types of financing (e.g. for PPPs</td>
<td>• on environmental risks and gender equality</td>
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<td></td>
<td>or the extractive sector);</td>
<td>• Private sector actors, including the insurance</td>
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<td></td>
<td>• National budget processes;</td>
<td>• sector</td>
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<tr>
<td></td>
<td>• Design and approval processes</td>
<td>• Development partners, e.g. the IMF and UN</td>
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<td>for major projects (e.g. in the</td>
<td>agencies</td>
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<td></td>
<td>infrastructure sector);</td>
<td>• Ministries of Finance; Ministries of Planning;</td>
</tr>
<tr>
<td></td>
<td>• Climate change and environmental impact assessments</td>
<td>Central Banks; Treasuries; National Bureaus of</td>
</tr>
<tr>
<td></td>
<td>• Gender impact assessments</td>
<td>Statistics; line ministries; regional and local</td>
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<tr>
<td>BB1.4 Binding constraints diagnostic</td>
<td>• Processes related to the</td>
<td>governments</td>
</tr>
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<td></td>
<td>identification of economic and</td>
<td>• Civil society, including women’s organisations,</td>
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<td></td>
<td>institutional constraints to</td>
<td>think tanks and NGOs</td>
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<td></td>
<td>sustainable finance, investment</td>
<td>• Private sector, e.g. associations for banking,</td>
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<td></td>
<td>and growth (including PFM</td>
<td>firms and trade union representatives, worker</td>
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<td></td>
<td>assessments);</td>
<td>unions</td>
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<tr>
<td></td>
<td>• Sequencing and prioritisation</td>
<td>• Development partners, (including the IMF, UN,</td>
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<td></td>
<td>processes;</td>
<td>OECD and AFDB)</td>
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</table>
5. BB1 Assessment and diagnostics checklist

The following checklist summarises key steps in INFF assessments and diagnostics. It is provided as reference for INFF oversight teams and stakeholders involved in the process.

- **BB1.1:** Clear understanding of the volumes and types of financing required to achieve national sustainable development priorities (what is the demand for financing)
  - Determine whether additional costing exercises would add value or whether existing information on financing needs is sufficient
  - If additional exercises are required, identify most appropriate approach and tools
  - Consult with relevant stakeholders to ensure that resulting information on financing needs reflects all knowledge and perspectives

- **BB1.2:** Clear understanding of current (and future) trends in financing, both in terms of volumes and alignment with national sustainable development priorities (what is the supply of financing)
  - Assess the current scale and sustainability of financing in the country
  - Determine what the major trends are and how the scale and mix of financing may evolve in the future
  - Assess the allocation and use of current financing, including in relation to contributions to national sustainable development outcomes
  - Determine where the main opportunities and challenges lie
  - Consult with relevant stakeholders to ensure that insight on trends across all types of finance is considered, including those for which data may be limited

- **BB1.3:** Clear understanding of how major risks the country faces could impact its ability to finance national sustainable development priorities, and what domestic and/or international policy action is needed to reduce vulnerability and maximise resilience
  - Identify what risks the country is exposed and vulnerable to
  - Establish the channels through which such risks can affect the country’s ability to finance sustainable development priorities over time and what additional costs related shocks and disasters may result in (and prioritise risks if necessary)
  - Assess the government’s capacity to deal with identified risks and determine what policy actions are required to strengthen such capacity, and how feasible and cost-effective they are
  - Consult with relevant stakeholders to ensure that all existing knowledge on risk and resilience is collected and can inform policy solutions

- **BB1.4:** Clear understanding of what the major impediments are that hinder adequate mobilisation and alignment of financing for national sustainable development priorities
  - Identify the problem areas where binding constraints analysis would be most useful
  - Determine what the fundamental underlying issues are that, if removed, would have the largest impact on the country’s ability to effectively finance national sustainable development priorities (i.e. the binding constraints)
  - Consult with relevant stakeholders to ensure that practical and sector-specific insight on problem areas and potential binding constraints is considered
  - Establish which binding constraints should be addressed first, ensuring coherence with sustainable development objectives