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The Crisis of Climate and Development Finance

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Oxford Martin School, May 22, 2025

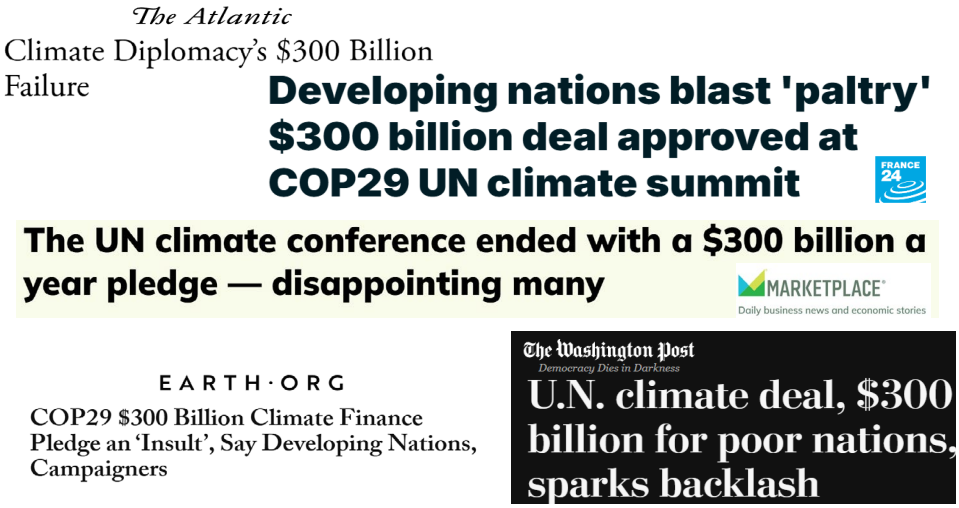
The world's richest nations have made considerable global financing promises to developing countries—including a $300 billion annual pledge for climate. But in the last few months aid budgets have been slashed across Europe and in the United States, even as financing is diverted from development and adaptation to projects that have little impact on greenhouse gas emissions. Meanwhile, attempts to unlock trillions in private investment at the project level using billions in aid have comprehensively failed. How can we effectively fund both climate action and development when current financing approaches are falling woefully short? Concessional finance for development and adaptation in the poorest countries, profitable lending for development and mitigation in richer developing countries.

The world's richest nations have made considerable global financing promises ...

In the Baku Climate Conference last year, participants agreed to increase climate finance from the $100 billion per year of the Paris Agreement to $300 billion a year by 2035. Many thought the number was too low—and it is true that it is very small compared to the estimates of financing needed for developing countries to help keep the world on track to 1.5 degrees. The Songwe-Stern Commission suggests around $2 trillion in finance a year is needed for mitigation in developing countries excluding China, and $1 trillion of that will need to come from international finance. And that is also only part of the investment needed to meet the United Nations Sustainable Development Goals.

At the same time, I think we were never going to get to trillions, in part because the scenarios for delivery unrealistically assumed the private sector would provide an immense amount of the cash. We will get to that later. But the more immediate problem is that real financing for development and climate adaptation is actually *falling*. One reason is that mitigation financing is eating up development finance even as it remains ineffective at reducing greenhouse gas emissions. That is what I want to discuss first.

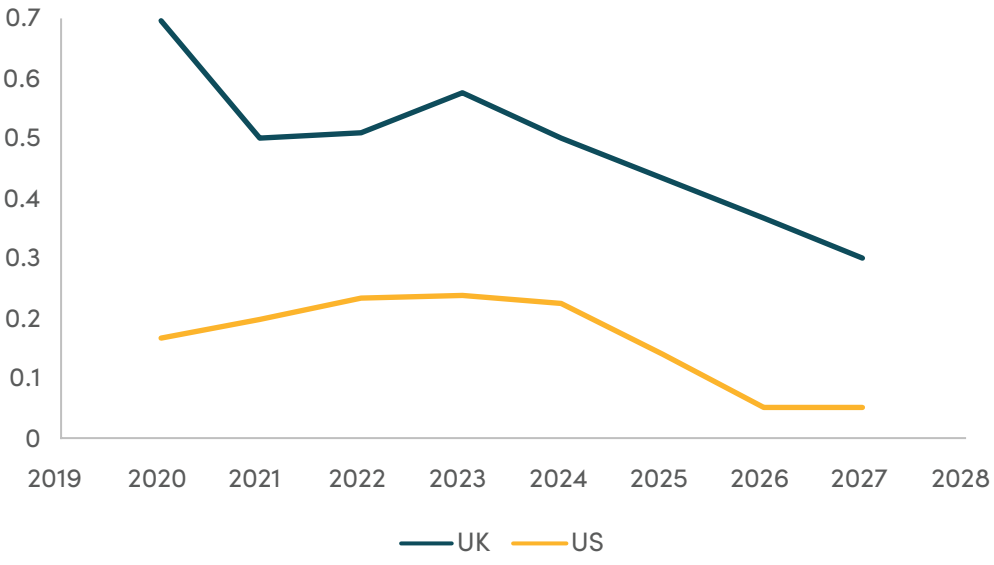
Figure 1. Promised Climate Largesse



… But in the last few months aid budgets have been slashed …

Donor negotiators did not go home from Baku and immediately start pushing parliaments and congresses to triple the financing they provide to developing countries. In fact, the last year has seen aid budgets slashed—perhaps most notably in the US, but with the UK and others not far behind. Were the US administration's proposed budget to be enacted, and if the UK follows through on announced reductions, US assistance as a proportion of GNI would drop by 0.1 percent between 2020 and 2027 and UK assistance by 0.4 percent.

Figure 2. Past and Proposed US and UK ODA Budgets, Percent GNI

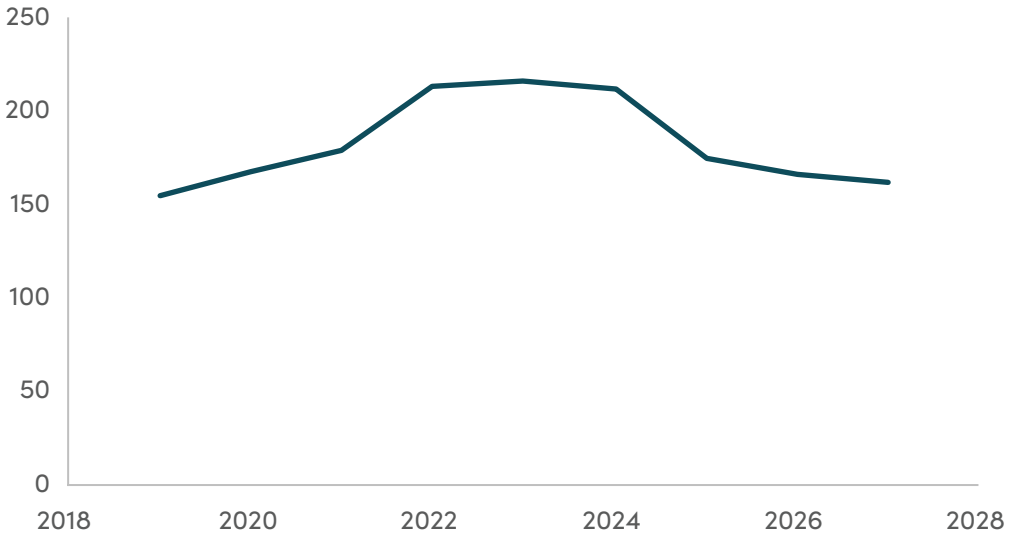


Source for US forecasts (using health, humanitarian and economic aid), source for UK forecasts, source for historical.

Robin Davis has made a global prediction based on announced cuts and the assumption of a two thirds cut in US assistance between 2025 and 2027. Depending on Congress, this may be pessimistic for the US, but he warns that there are also reasons the overall final outcome could be worse. The forecast suggests that, in constant dollars, global ODA in 2027 might be a third below peak. The better news is that this is still more than ODA was eight years earlier, before a rise driven in part by the war in Ukraine.

The bad news is that the cuts are affecting a lot of life saving assistance. With Justin Sandefur, I've estimated that the cuts so far by the US alone in the first few months of 2025 may be associated with 500,000 additional deaths each year, primarily due to more deaths from AIDS. The worse news is that, exacerbated by a tripled climate finance goal, there could be even more catastrophic times for lifesaving and development assistance ahead.

Figure 3. Global ODA Forecasts ($B)



Source

... Even as financing is diverted to climate projects ...

Not all climate finance draws on Overseas Development Assistance budgets, but a lot does.[1] ODA also includes a lot of spending that can't count as climate finance and frankly shouldn't really count as ODA either, including aid administration costs, most debt relief, and in-donor costs of housing refugees. The "country programmable" measure of ODA excludes these categories. Although it also excludes humanitarian spending, a portion of which can count as climate finance, that still makes country programmable aid a better measure to compare to climate finance when calculating how much real development aid is now climate-related.

1 In 2022, $25.6 out of a total of $91.6 billion of reported climate finance was provided as grants, according to OECD statistics. In addition, 79 percent of bilateral loans, 41 percent of multilateral climate funds and 23 percent of multilateral bank climate loans were concessional—and nearly all of that involves at least some spending counted as ODA.

Using a low end estimate for 2022, about $46 billion in total climate finance was supported by ODA, a little more than half of total reported climate finance in that year. That compares to about $125 billion in total country programmable aid. As a back of the envelope calculation, then, more than a third of ODA that actually funds investments in developing countries is already used to finance climate projects. Multiply the need for climate finance from $90 billion to $300 billion and keep the proportion that comes from ODA the same and it eats up more than all country programmable aid. There would be nothing left to finance investments in developing countries for anything other than climate-related activities.

Figure 4. International Finance: Climate And ODA (2021)

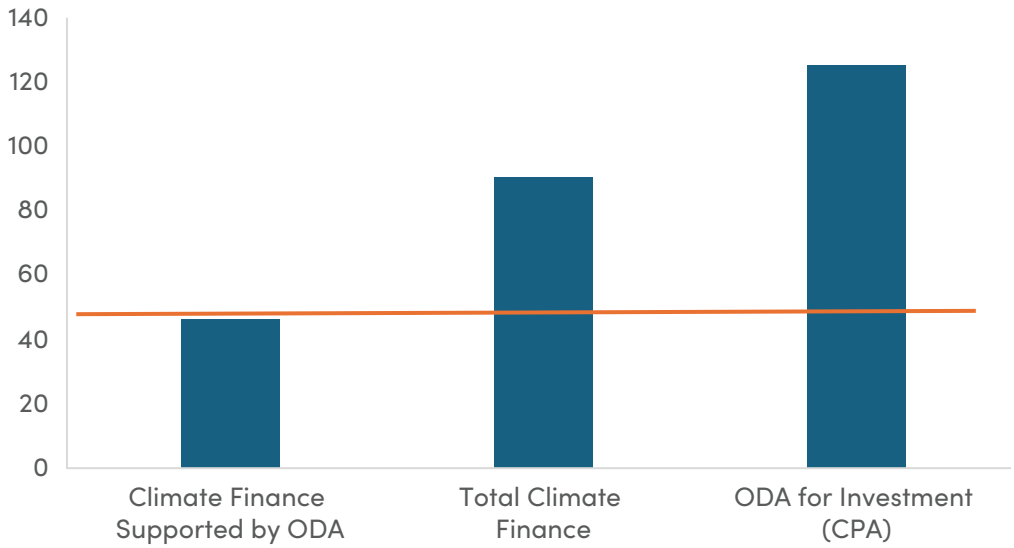
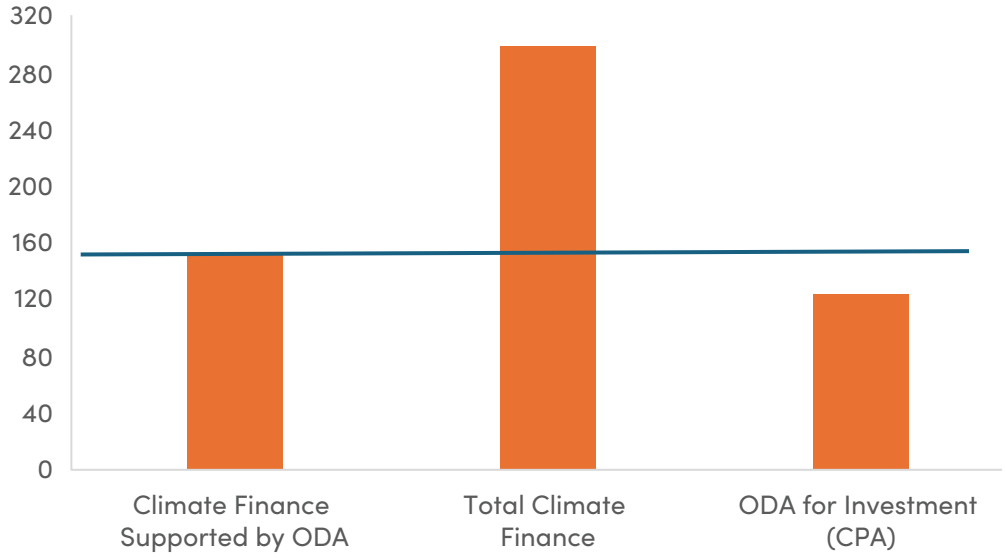


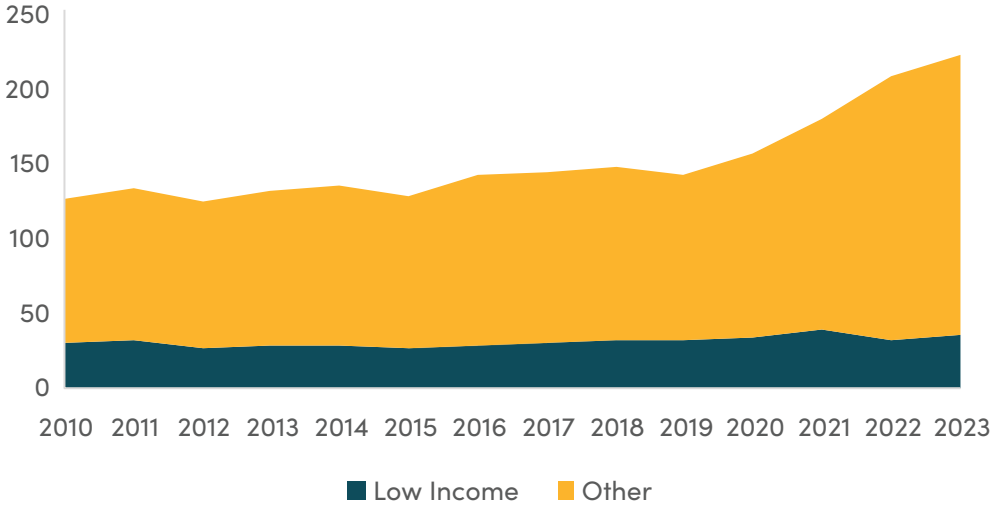
Figure 5. International Finance: Climate Eats ODA (Post-Baku?)



Meanwhile, for all it should have done, the climate emergency simply hasn't incentivized greater international financial generosity from richer countries. Earlier talk in the climate community that climate finance should be "new and additional" has been abandoned. Studies from CGD and elsewhere have shown climate finance diverting, rather than significantly adding to, ODA.

As a share of donor economies, total overseas development assistance fell from 0.35 percent in 2009 (when the $100 billion target was first agreed) to 0.33 percent in 2024, suggesting no additional financial effort. We've seen that number is likely going to further decline over the next few years. Meanwhile, ODA to the poorest countries—low income countries with an income per capita below about $1,000 per year—was $31 billion in 2011 and $32 billion in 2023, a per capita decrease, reflecting a declining share of total ODA.

Figure 6. Distribution of Country-Allocable ODA

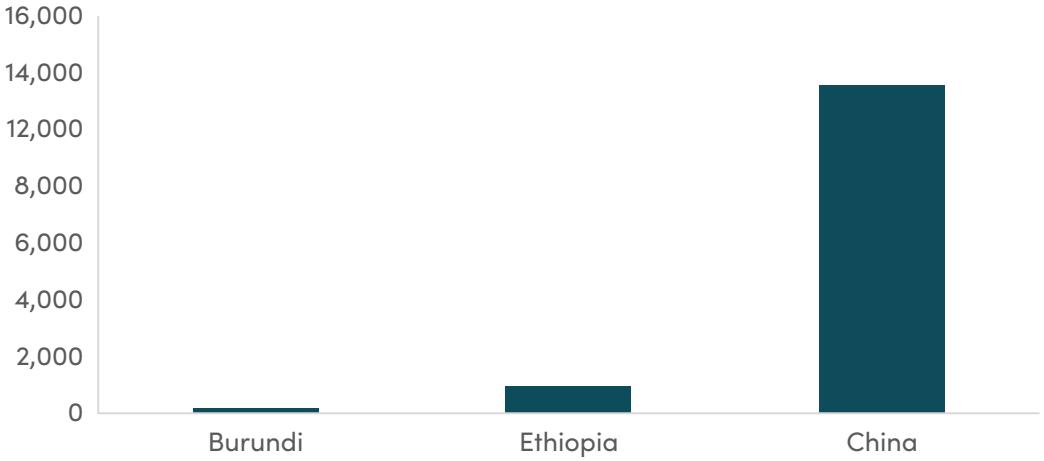


Source

And that declining low-income share reflects the fact there is a real tradeoff between finance for climate mitigation–reducing emissions—and finance for broader development as well as support for climate adaptation.

Development finance is best spent in the poorest countries where it will have the biggest impact on the quality of life of the world's poorest people. A dollar of assistance just makes a lot more difference to people in a country with a income per capita of $220 like Burindi than people in a country with an income per capita of $13,000 like China.

Figure 7. The Range of Income Per Capita in the Developing World



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And ODA works in those poorest countries, where a one percentage point increase in the aid to GNI ratio raises annual growth by about 0.35 percentage points. That spending is also a good use of adaptation finance—development is a resilience strategy, and many of the poorest countries, strung across the tropics and highly reliant on rainfed agriculture, are among the most urgently in need of adaptation support.

But low income countries are currently responsible for 0.5 percent of global greenhouse gas emissions and will continue to be minor emitters decades from now. Compare richer developing countries including China, Brazil and India, which are already major emitters. Upper middle income countries in particular account for the considerable majority of developing country emissions. We'll see these are also the countries where the subsidy costs for introducing zero-carbon approaches are comparatively low—far lower than in the poorest countries. They are where a dollar of climate finance is likely to have the greatest impact on the climate.

That means "good" mitigation finance looks different from "good" adaptation and development finance. Where the best adaptation and development financing will be used in the poorest countries, the best mitigation financing is likely to be in richer, larger countries.

Adding to the problem, from a donor perspective, cheap climate finance looks very different from effective development and adaptation assistance. Donors can count a portion of profit-making lending to richer developing countries as ODA along with the total lent value as climate finance, so they have a strong incentive to shift ODA spending from costly grants to development and adaption in poorer countries to support revenue-raising loans for mitigation in richer developing countries.

Under the circumstances it should be unsurprising that within climate finance, mitigation is winning out over adaptation, and richer developing countries are winning out over poorer ones. Mitigation accounts for over seventy percent of total climate finance and low income countries received just $11 billion out of $116 billion of reported climate finance in 2022. Again, that helps to explain low income countries' declining ODA share that we saw earlier.

Figure 8. International Climate Finance: Adaptation and Mitigation (2022)

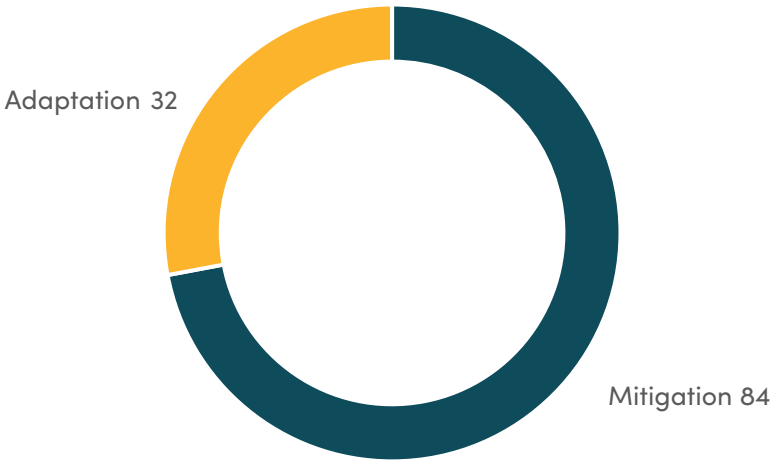

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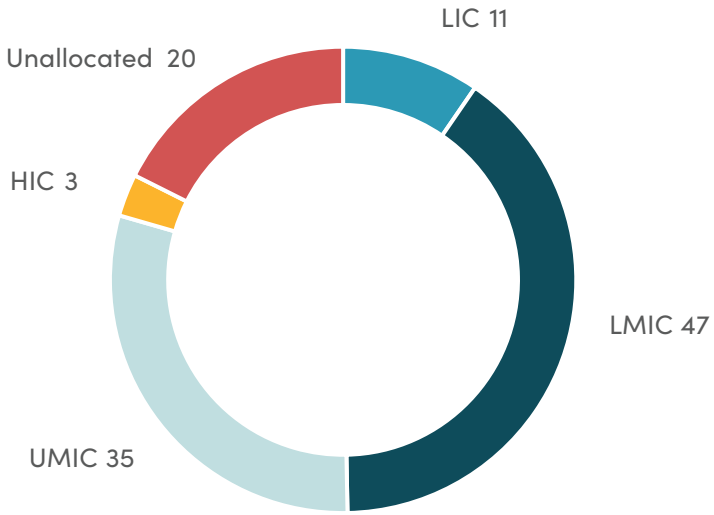
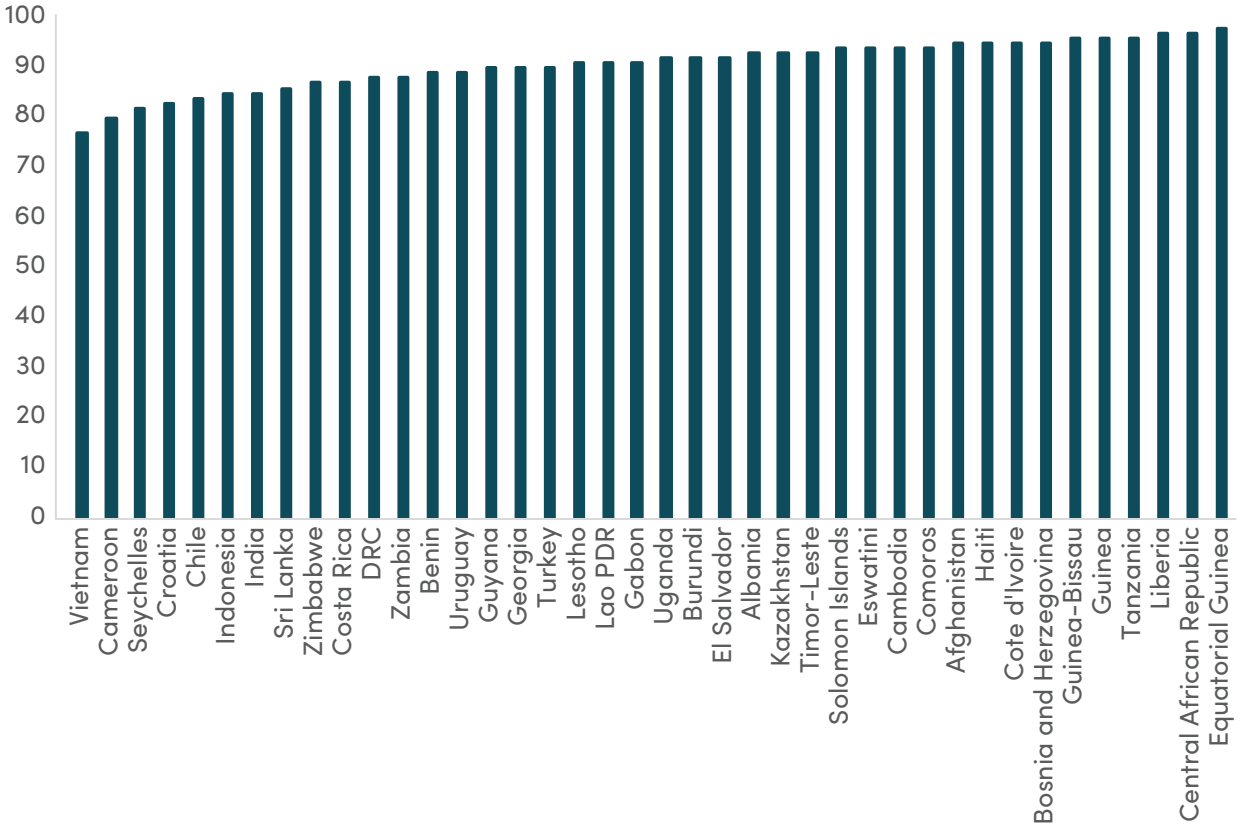
Figure 9. Distribution of Climate Finance, 2022, $bn



Source

It is perhaps worth noting at this point what aid recipients think international finance should be spent on. They want donors to focus on education, infrastructure and growth, not climate. Between 2020 and 2021, the World Bank completed 43 surveys of client countries with representatives from government, aid agencies, media, academia, the private sector, and civil society. On average, less than 6 percent of respondents listed climate as one of their country's top three development priorities. When it comes to which sectors respondents believed the World Bank should dedicate the most resources, climate reached the top ten in only seven out of 43 countries and none of those seven are among the poorest World Bank clients.

Figure 10. Percentage of Respondents Who Do Not Think Climate Change is One of Their Country's Top Three Development Priorities



Source

It might also be worth thinking through what a climate justice approach suggests. Using the Stern discounting rule, a dollar spent on mitigation rather than consumption has a bigger negative impact on quality of life in low income than rich countries. Furthermore, these are the countries already suffering the most from the impact of climate change—something they didn't cause. They have the absolute right to prioritize development over mitigation and to expect outside support to help them do that.

... that have little impact on emissions.

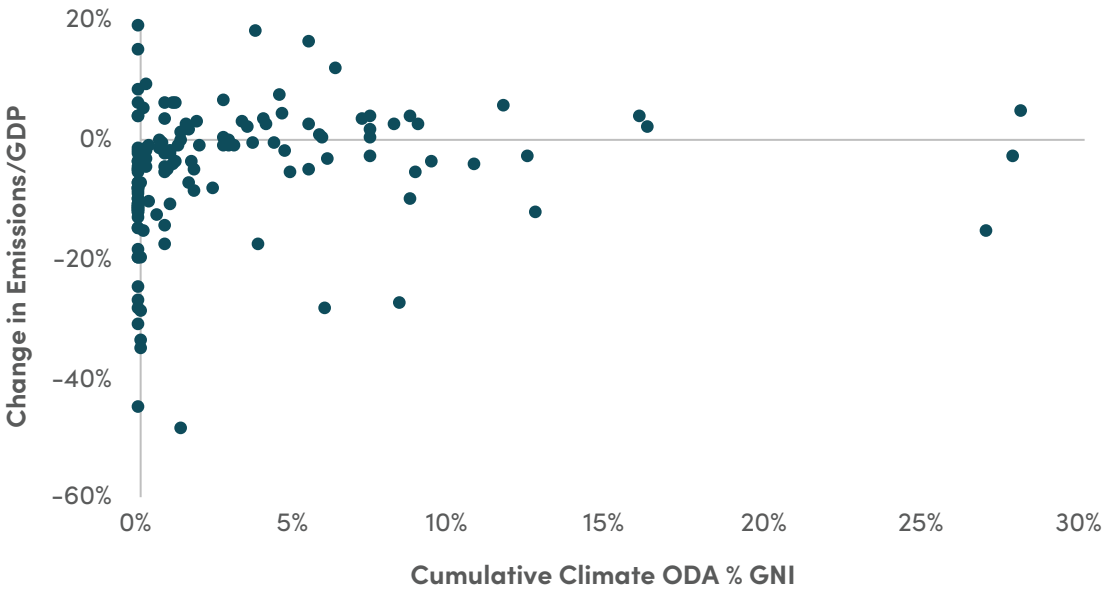
This is especially the case because mitigation financing isn't working. Analyses looking at the relationship between past ODA climate finance for mitigation and subsequent emissions find a mostly positive relationship—more finance, more emissions—which is not what you'd hope to see.[2]

Look at mitigation ODA between 2000 and 2020. It totals $185 billion worldwide. The chart uses cumulative climate mitigation ODA data from the OECD, divided by recipient country GNI, and kilograms of CO2 emissions per dollar

2 See Gavard and Schoch and Han and Jun,

of GDP in 2000 and 2020. There is no significant association between more ODA-financed mitigation spending and lower emissions intensity. Again, regression analysis suggests the relationship is usually positive—receiving more mitigation funding is associated with your economy becoming more carbon intensive.

Figure 11. ODA for Climate Mitigation and Emissions Intensity 2000-20



Source

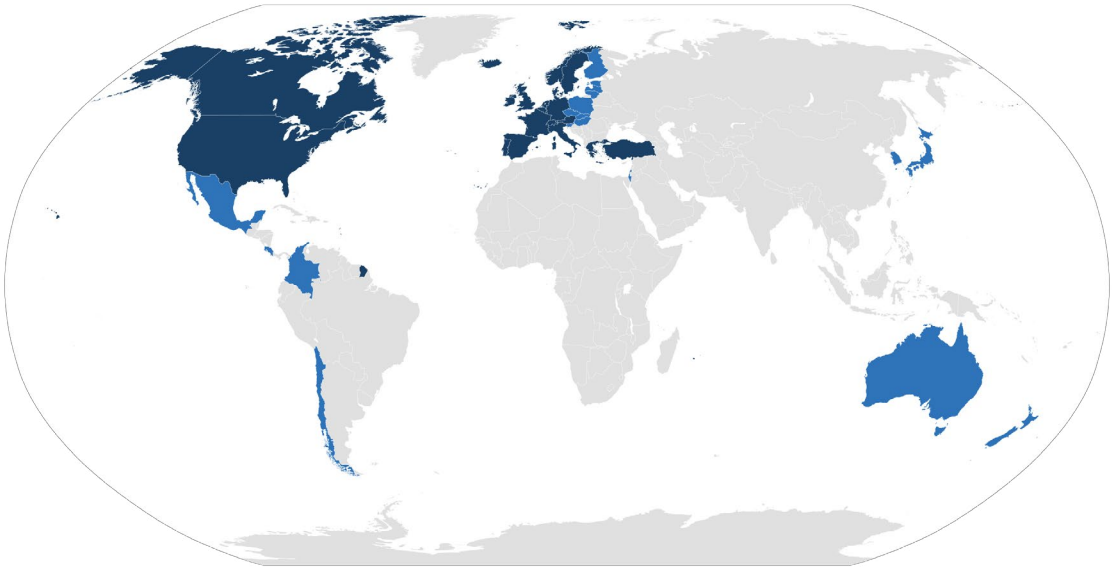
For 35 recipient countries, the cumulative total of mitigation ODA as a proportion of GNI over 20 years is more than 5 percent. This is serious spending. For comparison, ten-year cumulative spending planned under the US Inflation Reduction Act added up to about 1.6 percent of US GDP. And yet Mitigation ODA isn't associated with lower emissions. Between 2000 and 2019, while Kiribati received 28 percent of its GNI in mitigation finance, it has seen annual emissions rising from 36,000 to 57,000 tons of carbon dioxide. Some of the climate spending was meant to be "dual purpose," supporting both mitigation and adaptation, and you can only hope it did a better job of helping the small island nation prepare for the impact of climate change than it did in reducing emissions.

Figure 12. Tarawa, Kiribati: An Experiment in the Efficacy of Climate Mitigation Finance

Source

Mitigation finance is what we got when we couldn't agree a global carbon market. It doesn't appear to be a very effective substitute. And that's in part because of who gets to decide what counts as finance: that would be pretty much the same OECD member countries who get to decide that spending money on hotels in Brighton to house asylum seekers counts as overseas development assistance.

Figure 13. OECD Member Countries



Source

Having agreed to find $100 billion in finance—and now $300 billion in finance—these countries have had every incentive to be generous as to what is included in the total. That flexibility covers the kind of finance (grants, loans, "mobilized" private finance) and what it supports. You may recognize Geert van Rampelberg, he is the Belgian heartthrob star of the movie La Tierra Roja set in the forests of Argentina: the film itself was supported by some of Belgium's contribution to the $100 billion climate finance goal.

Things that have been branded as climate finance for mitigation alongside motion pictures include investments in gelato stores, doing municipal transparency in Gaza, and teaching reform at higher education institutions. The World Bank alone has tagged 114 different education projects with a climate label, including ones that focus on teacher training, education governance, student assessment, education financing, standards, curriculum and textbooks, private sector delivery of education, and education access.

Perhaps unsurprisingly, donors don't appear to be particularly keen to measure the efficacy of their mitigation spending. But in the few cases where you can find project efficacy data, in the portfolio of the World Bank Clean Technologies Fund and the Green Climate Fund, aid-financed climate projects reduced emissions at reported costs of between $10 to $1,000 per tonne of CO2 equivalent averted, suggesting a lot of rather inefficient projects.[3]

The Potemkin features of climate finance reach their most rococo with regard to "mobilized private finance," where donor action supposedly incentivizes private investment in developing country climate projects. For private funds to count as climate finance, according to the OECD, "the general assumption is that the private sector would not have invested in a given company in a developing country without the official sector involvement"—i.e. mobilization is taken as given. Theoretically I could lend a dollar on behalf of the UK government to a $5 billion private solar project in China, claim the assumption that it was my dollar that made the difference and presto, there is $5 billion in climate finance.

To be fair to donors they don't tend to be that brazen, but that brings us to this oft-heralded solution to massive global investment needs absent donor desire to provide any money: the green fairy godmother, the magic pony, that is private finance.

Meanwhile, attempts to unlock trillions in private project investments have failed

As the climate finance ask gets bigger, the amount donors plan to rely on the private sector to deliver on it increases even faster. Look at the teetering "Just Energy Transition Partnership" agreement between donors and Indonesia, designed to speed that country's path to low-carbon development. It proposed leveraging $10bn from the private sector using around $2 billion in guarantees and market rate loans from donors and just $300m in grants and technical assistance.

3 It's worth noting the Clean Development Mechanism, which provides carbon credits to developing country low carbon projects that can be sold to polluters operating under a emissions trading regime, isn't working either. It has largely backed projects that would have happened anyway. Looking at Indian wind farms that received credits, about 52% of carbon offsets were approved for projects that would have happened absent a subsidy, and the sale of those offsets to regulated pollutors led to higher greenhouse gas emissions than absent the CDM.

Parts of the private sector are happy to play along. That should come as no surprise given it could involve huge handouts from governments. BlackRock is a US-based investment manager. It has proposed a $100 billion dollar annual grant mechanism to "de-risk" private climate investments in developing countries through "greater public sector exposure to loss." As we've seen, that would more than eat up all ODA for investment, and it isn't at all clear what we'd get in return in terms of either mitigation or sustainable development. As a result, it is a little hard to tell which kind of magic pony BlackRock represents, but perhaps the greatest fear is that it's an inadequately enchanted donkey.

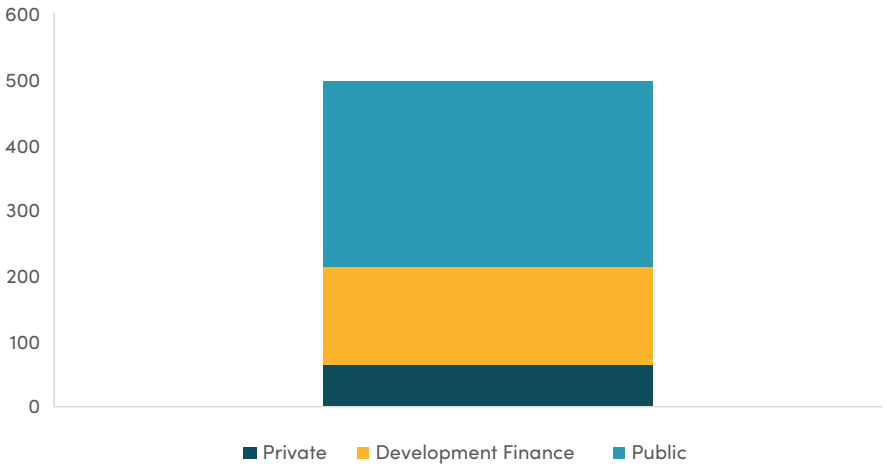
Figure 14. Private Sector Trillions for Climate?

Figure 15. Blackrock: What Kind of Magic Pony?

Source: Author's Creation.

The Songwe-Stern Commission I cited earlier suggests we would need to increase annual private climate financing for developing countries excluding China from approximately $69 billion to $395 billion to help achieve climate goals. This will largely involve supporting infrastructure.[4] But, currently, only about 13 percent of infrastructure financing is provided by the private sector in low and middle income countries. And in the last decade, institutional investors like Blackrock contributed about 0.67 percent of the total private participation in infrastructure investment in those countries.

Figure 16. LIC/MIC Infrastructure Finance by Source ($bn)



Source

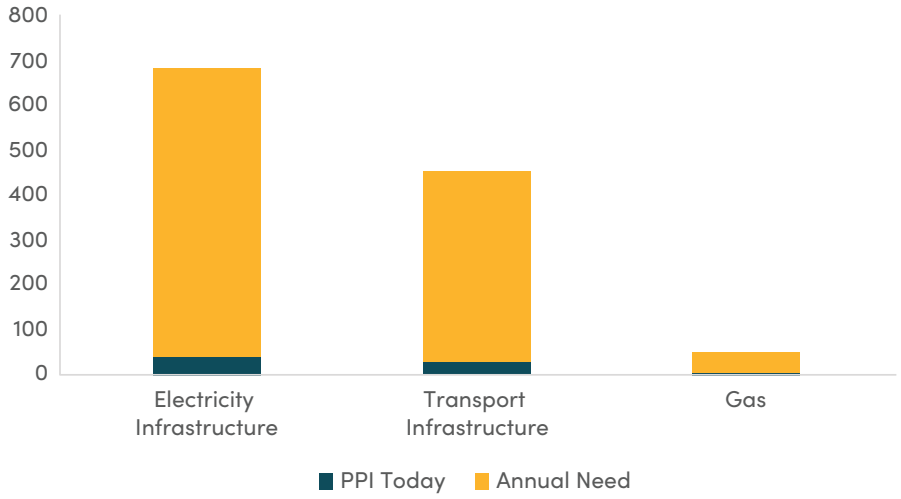
That reality is reflected in the World Bank Group, an early and consistent champion of private finance for infrastructure. In 2023, its private sector arm the IFC provided $2.5 billion in long-term finance to infrastructure, about 15 percent of its business. That compared to World Bank public sector financing to infrastructure of $10.5 billion, or 27 percent of its business.[5]

In order to meet the investment needs laid out in global stocktaking exercises, annual financial flows to developing country electricity projects outside of China would have to reach about $680 billion a year and for transport $450 billion. It is worth comparing that to annual public-private infrastructure projects worth below seven percent of that level in both sectors.

4 Looking at where current reportedly "mobilized" private finance is used according to OECD statistics, 58 percent goes to energy, transport and water supply (a further 14 percent goes to banking and finance, and presumably some of this is used to finance infrastructure in addition).

5 It isn't just in developing countries: in 2018 less than five percent of infrastructure investment took place via public-private partnerships in 19 out of 24 OECD economies surveyed.

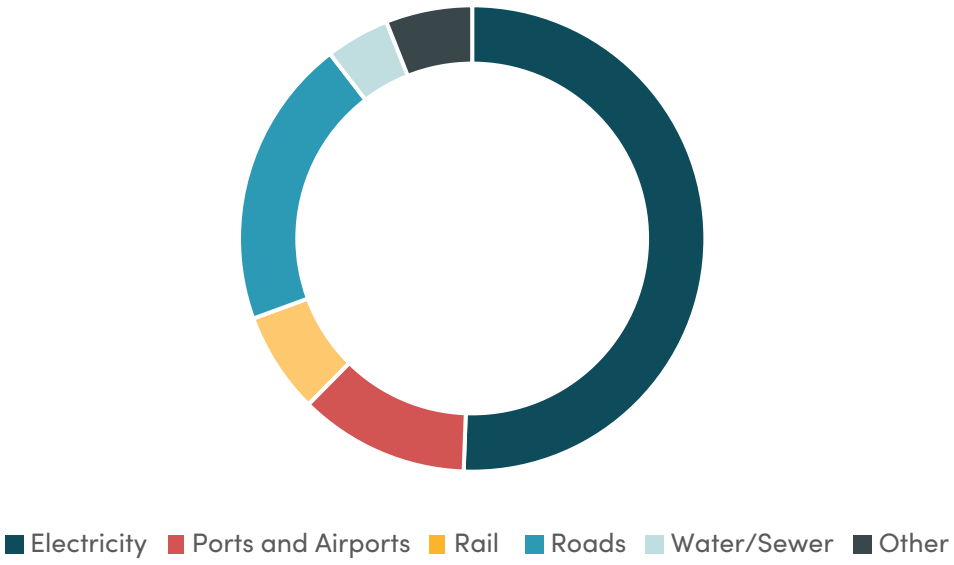
Figure 17. Investment "Needs" Compared to Private Participation in Infrastructure



Source: for developing country (ex China) infrastructure needs Report of the Independent High-Level Expert Group on Climate Finance For PPI, this is the sectoral scale estimated using 2023 total flows and sectoral shares over the past 20 years from the World Bank PPI Database.

Over time, electricity has accounted for about half of all public-private infrastructure projects, and it is true that for solar and wind, private providers are responsible for the considerable majority of sponsored projects—although these projects are mostly small scale and considerably subsidized.

Figure 18. Share of total PPI in Developing Countries Across Sectors



Source

Figure 19. LIC/MIC Infrastructure Project Sponsors by Sector and Value of Investment (%)

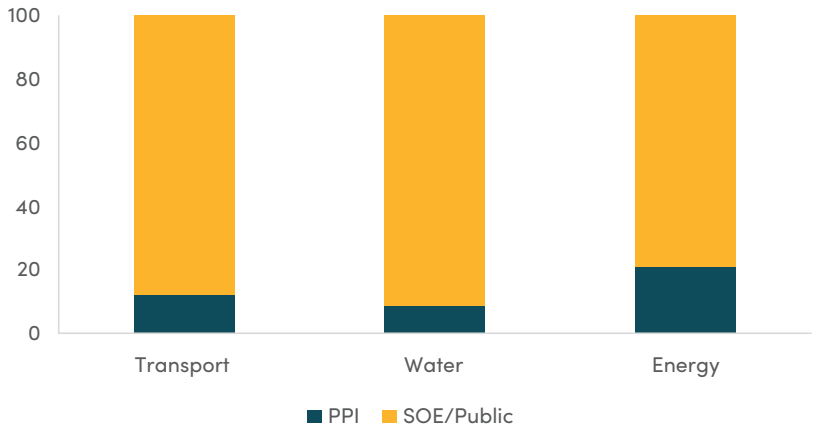


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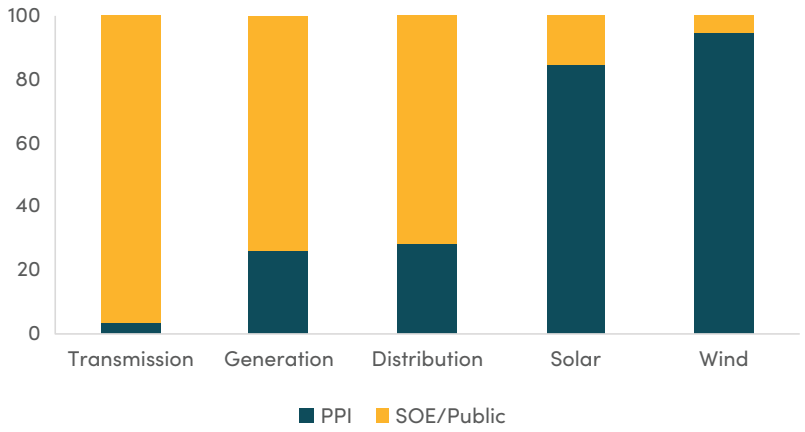
Figure 20. LIC/MIC Electricity Project Sponsors by Sector and Value of Investment

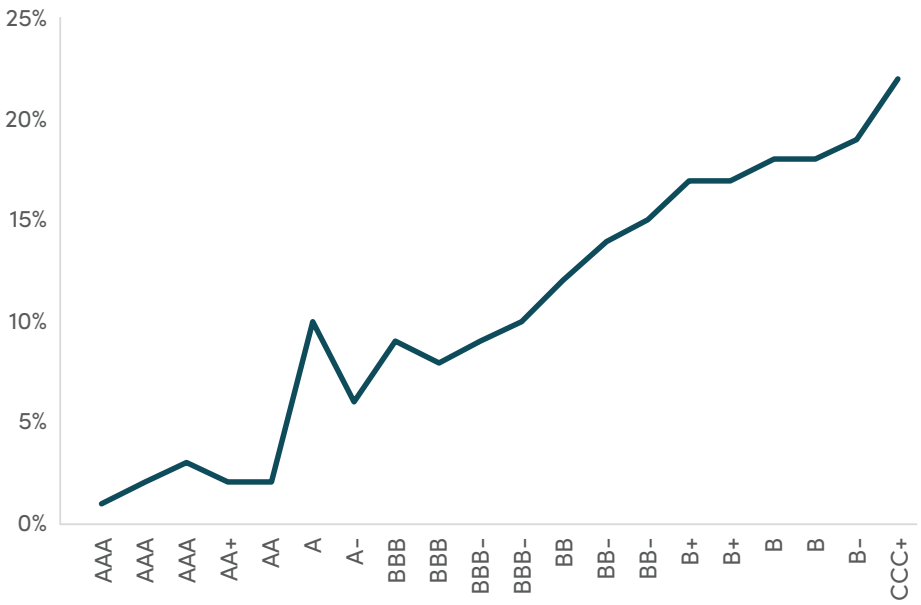


Source

That's because the rates of return demanded by private providers and financiers, especially in the poorest countries, make private power projects very expensive. The chart orders a number of developing countries by their credit rating and associated estimated cost of (debt) capital for private sector solar projects. It suggests a cost of 24 percent in B-rated Tanzania for example. Data from European Bank for Reconstruction and Development private infrastructure projects suggest an average of a 23 percent financial rate of return even for the countries the Bank covers, which are largely safely middle income.

Host countries try to lower those costs through agreements including purchase guarantees (that they will buy the power regardless of whether it is needed), price commitments, and providing their own financing or subsidies, but these all add to the real cost of the project for the economy. A recent World Bank Group program designed to demonstrate that solar projects in lower income developing countries didn't need subsidy instead demonstrated it took about $2 in subsidies to attract $1 in private finance.

Figure 21. Estimated Cost of Debt for Private Renewable Energy Projects by S&P Rating, 2023



Source: Selected countries from Gautam et al Cost of Capital for Renewable Energy Investments in Developing Economies Annex II

That's why even in infrastructure investments sponsored by private providers, about 55 percent of the actual finance is provided by the local and international public sector. Again, the private sector only accounts for about one quarter of the finance in climate projects involving blended public and private finance, with below-market finance including ODA accounting for more than a third. This is a particularly acute problem in the poorest countries where it is taking one dollar of public finance to mobilize 37 cents of private finance.

Figure 22. LIC/MIC Infrastructure Finance by Source and Sponsor ($bn)

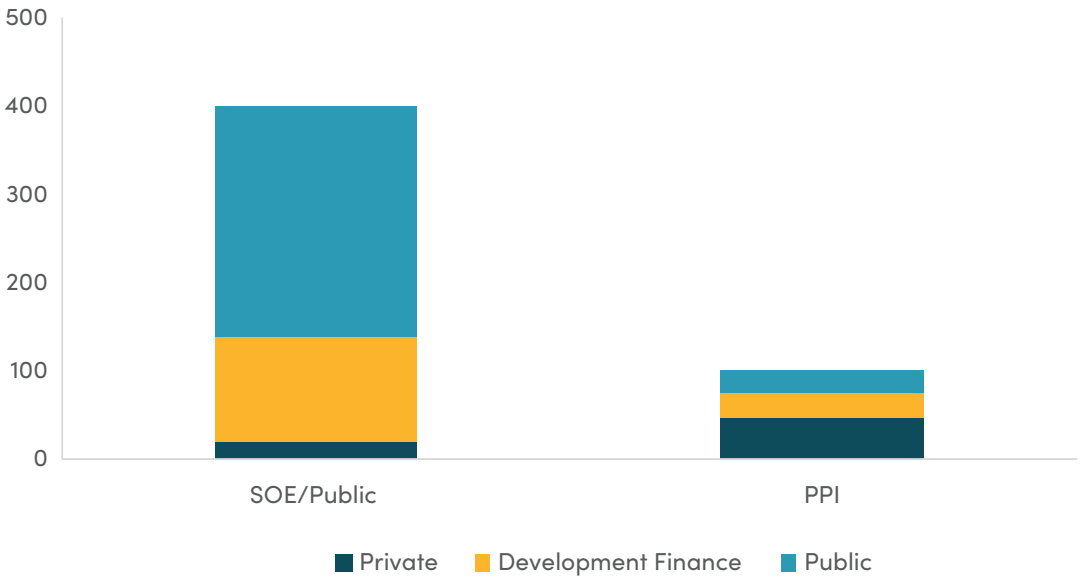


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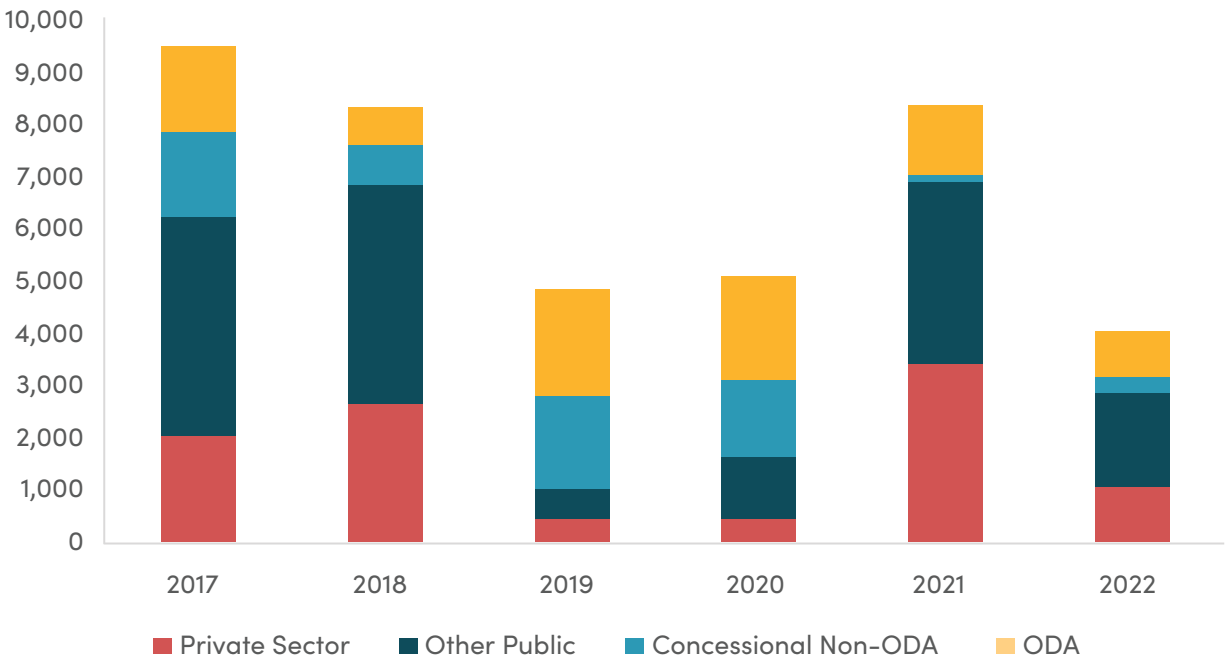
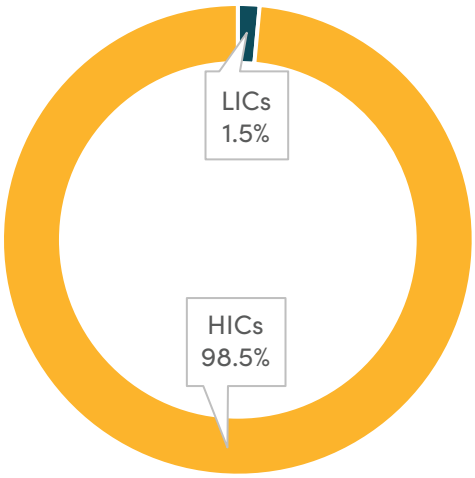
Figure 23. Who Finances "Blended Finance" Climate Projects ($Bn)



Source

That will all help explain why despite low income countries being home to about 11 percent of the population of the developing world, they account for just 1.5 percent of public-private infrastructure deals on average, that add up to $1.28 per person per year.[6]

Figure 24. PPI By Income Group 1999-2023



Source

6 Meanwhile, OECD statistics suggest just 3 percent of "mobilized" private climate finance flowed to low income countries.

None of this is for lack of trying by donors. By 2012, there were already 67 facilities funding private infrastructure project preparation in Africa alone. More were founded after, including many of those on the figure, providing project preparation and transaction support, equity, credit enhancements, secured loans, refinancing, secondary transactions, subsidies, guarantees, and more. The Private Infrastructure Development Group, for example, committed about $4 billion in preparation and financing of projects between 2002 and 2019.

Figure 25. PPI Facilitation: A Popular Idea

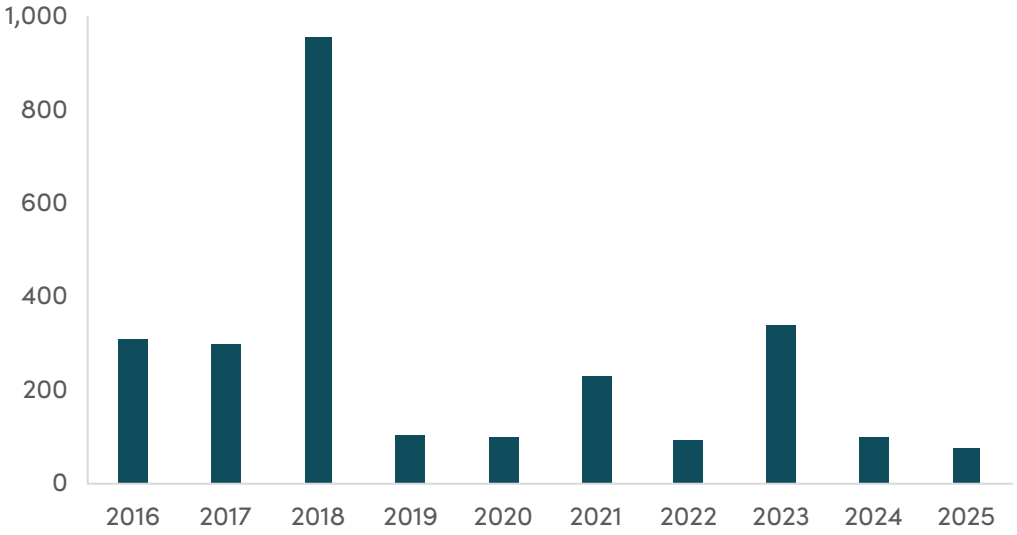
In addition, between 2018 and 2022, donors provided nearly $18 billion in bilateral ODA to "private sector instruments"—capital increases to bilateral development finance institutions or subsidies to those institutions to support private sector investments in low and middle income countries. The UK provided about $4.4 billion in capital to British International Investment (BII) over that time, for example.

There have also been recent (partially) ODA-funded capital increases at multilateral private sector development finance institutions including $5.5 billion at the IFC, $3.5 billion at IDB invest and about $4.3 billion at the EBRD. And subsidy mechanisms have been introduced, including the IDA Private Sector Window, which provides subsidized finance primarily to the IFC out of an allocation of $2.7 billion. It all sums to about $5 billion of ODA a year going to development finance institutions.

But the model isn't working: IFC uses subsidies when it looks at the deal and decides it can't support it on market terms. Private financiers look at these deals and reach a similar conclusion to the IFC: without subsidized capital, these projects aren't a good investment. That's why private finance—mostly sponsor investment—accounts for only $4.6 billion out of $13.4 billion of subsidized project finance in 2021, with the rest provided by governments.

IFC's subsidized projects mobilize 60 percent less private capital per dollar of IFC investment than IFC projects in the same countries that do not rely on subsidies. And it is perhaps unsurprising there is no evidence that the subsidies to the IFC to do more in the world's poorest countries have had any impact on the scale of IFC investments in those countries—indeed, since the subsidies have begun, the IFC is working less in low income countries.

Figure 26. IFC Investments in LICs ($M)



Source

IFC's investments in low income countries amounted to $92 million in FY2024, or about 0.5 percent of the Corporation's commitments that year, a share that is shrinking. European development finance institutions are down to 12 percent by 2023. Low-income countries get just 13 percent of the concessional finance utilized by development finance institutions—that's less than upper-middle-income countries (which get 20 percent). In particular, the role of international private finance in infrastructure, health, and education in low-income countries remains (extremely, increasingly) marginal.

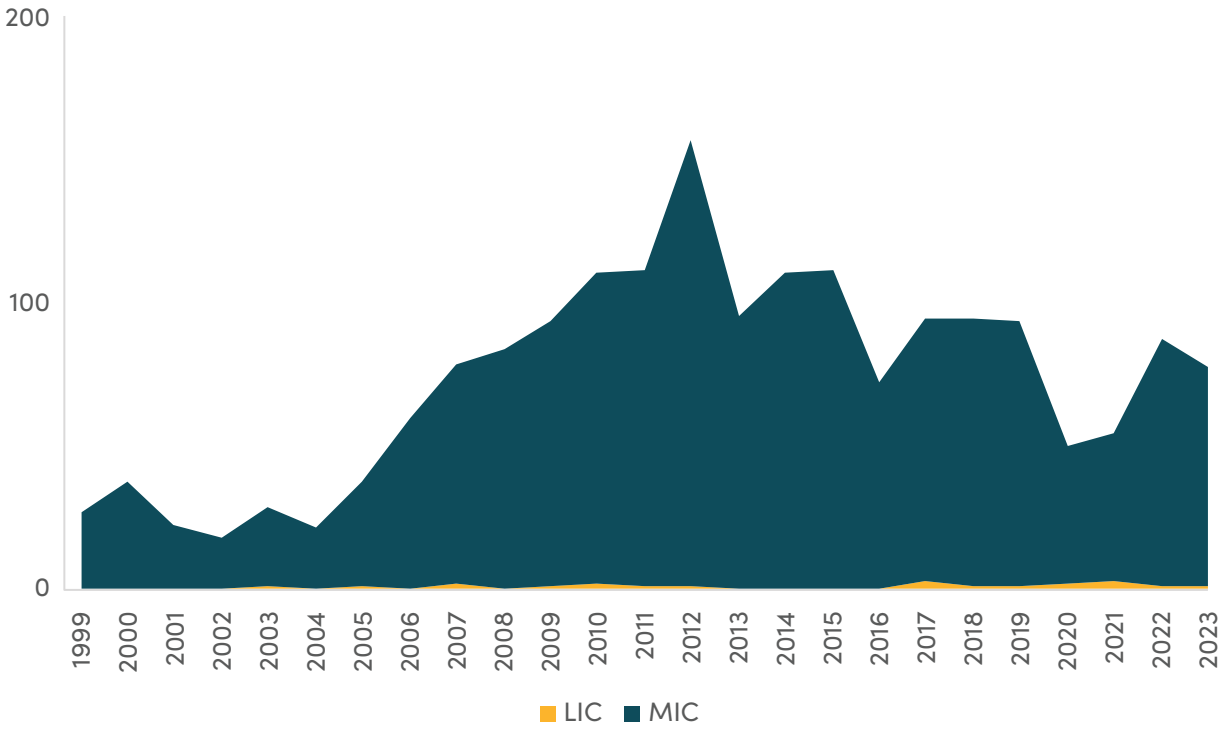
Beyond high prices and extensive guarantees and subsidies, the private infrastructure deals being struck often sacrifice a lot to get over the line to completion. The World Bank's regulations are clear only in "exceptional circumstances" will the bank agree to non-competitive public-private partnership selection. And yet, for example, IFC is using subsidies to back the Upper Trishuli dam in Nepal, awarded noncompetitively. The IFC was involved in 18 large electricity generation projects between 2015 and 2019. Of those projects, only eight were awarded competitively.

And the need for high prices, financing, subsidies and guarantees to attract private investors is one reason private electricity projects have such a mixed record. They can bankrupt the national distributors who have to buy their power. Private power producers supply 25 percent of Kenya's power, but account for 47 percent of the distributor's power purchase costs, for example. In Ghana, arrears to private power producers were worth 2.3 percent of GDP at the end of 2022 much of which was for unused power. In Pakistan, where the electricity sector contributed to a fiscal crisis in 2024, some private power producers earned annual real returns on equity above 80%.

It isn't surprising that broader development outcomes are disappointing: while there is a relationship between IFC investments in private infrastructure and subsequent private investment, there is no significant link between IFC investment and subsequent sectoral outcomes like power consumption or access. (Nor, it should be noted, is there a relationship between the level of overall private sector investment and infrastructure outcomes at the cross-country level).

Finally, the capital investments and subsidies and project preparation facilities and guarantees and the rest that are using up scarce ODA have all been associated with declining private financial flows. Private participation in transport, waste, energy and water and sanitation infrastructure in developing countries peaked in 2012 at $157bn. In 2023 it was just under one half of that level.

Figure 27. Total Value of PPI Deals in Developing Countries ($Bn)



Source

Indeed, total private sector flows to developing countries turned strongly negative recently, pointing up that donor efforts to mobilize finance for climate and development are marginal compared to the impact of domestic policies in donor countries on interest rates and trade which are never going to be dominated by concerns of low income country investment.

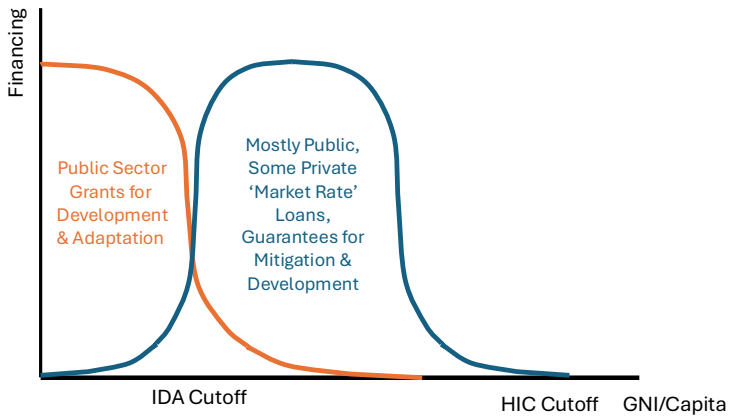
There are ways to improve things: revising regulatory barriers to investments by insurance and pension funds that make investing in developing country infrastructure unattractive, for example. But even after two decades of donor efforts to raise trillions in development finance using billions in public support the record is one of low leverage, high cost, limited development impact and small and declining scale. The magic pony of the private sector simply isn't flying to the rescue when it comes to climate, and even less so when it comes to development in the poorest countries.

The bottom line: we need grants for adaptation/development, lending for development and mitigation ...

To repeat, the poorest countries are utterly marginal in the fight for lower global emissions, while they are on the frontline when it comes to the impact of climate change. They are also where ODA can make a plausible and significant difference to development and wellbeing including through adaptation. Available global concessional finance must be concentrated in these countries, not diverted to governments and firms in far wealthier parts of the world. Climate mitigation and development finance in middle income countries can be sponsored using market-rate finance.

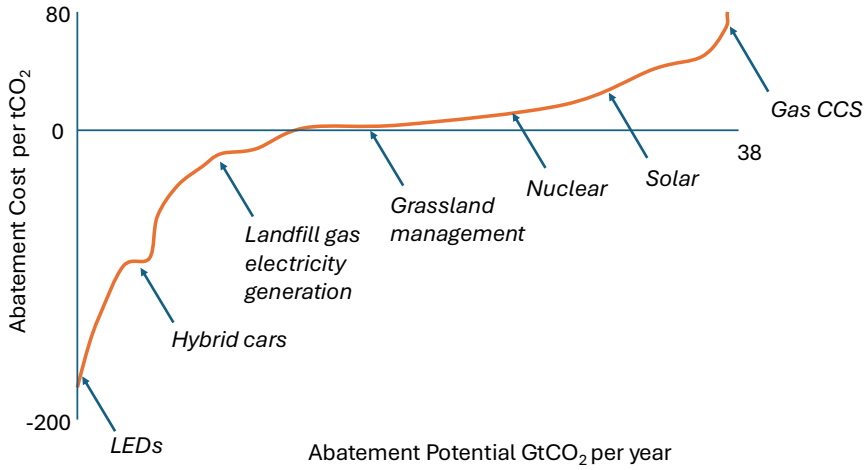
Perhaps the most efficient multilateral tool to support low income countries is the World Bank's highly concessional lending arm, IDA. Providing more resources to multilateral organizations like IDA will undo some of the damage caused by decline and diversion of assistance. Donors must ensure they won't make the world's poorest people pay twice for climate change—facing the most harm, while losing resources to mitigation spending elsewhere. That's why it is particularly shocking that the US and the UK are both walking back their pledges to IDA as part of aid cuts (although the US by less than you might expect).

Figure 28. The Allocation of Climate and Development Finance



Regarding climate mitigation, that is a battle that will be won or lost in far wealthier countries responsible both for the bulk of emissions and the considerable majority of research into zero-carbon solutions. Look at a cost-curve of global low-carbon technologies. At the left, those that are already cost-saving, like replacing incandescent lights with LEDs. Here the challenge to adoption isn't usually finance but something else—politics, as it might be. At the right, approaches like carbon capture and storage from gas-fired power plants that is very expensive.

Figure 29. Potential Abatement Cost Curve for 2030



Source

There are two basic ways to ease the economic challenges of global mitigation: first, lower the cost curve through technology advance—the more efficient solar cell or the improved battery. Or, second, lower the cost of investment in those technologies through cheaper finance.

Figure 30. The Impact of Better Technology

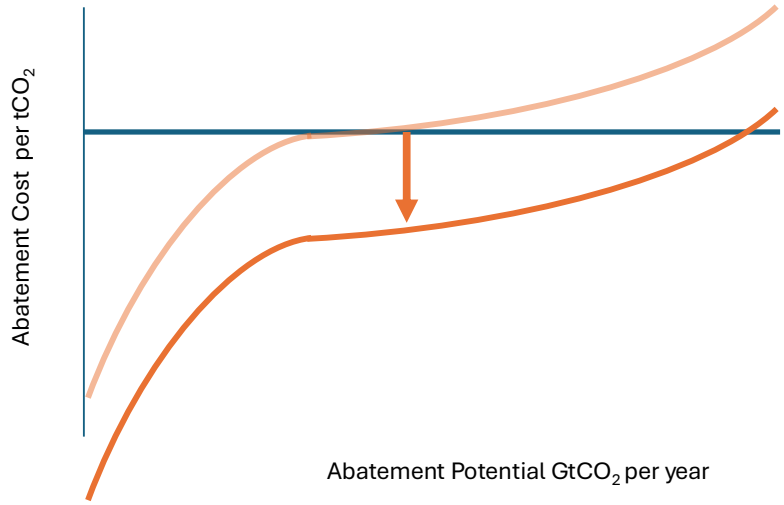
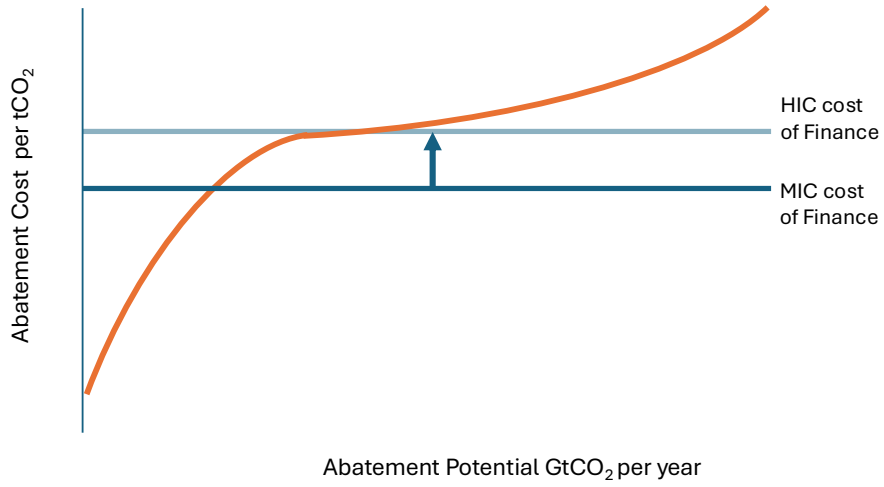


Figure 31. The Impact of Cheaper Finance



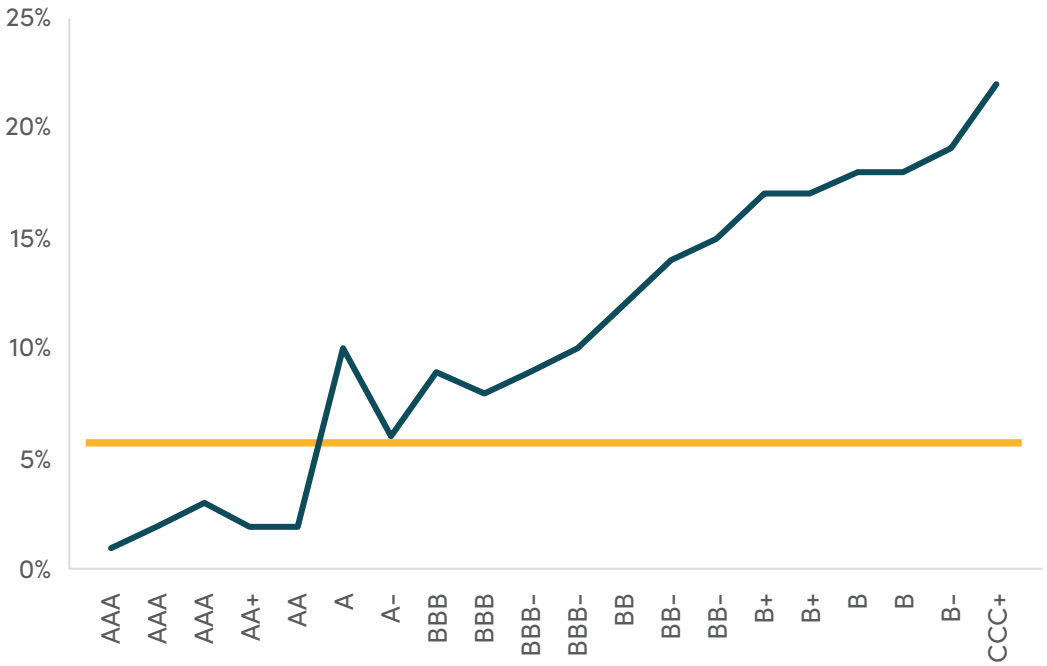
On the technology side, China, the US, Japan, the Republic of Korea and Germany between them accounted for 93 percent of resident patent applications worldwide. In these countries, further research, development and scaling of low- and zero-carbon technologies should be the priority–with a global benefit. There has been a 97 percent reduction in the price of both solar panels and batteries over three decades, for example. The more that the cost of zero carbon approaches declines, the less need for external finance to support their rollout in poorer countries.

But, especially in middle income countries, there is a considerable role for lowering the cost of finance. To put it another way, we should level the financial playing field so that more zero carbon approaches that are least-cost in the richest countries are also least-cost in middle income countries. The question is how to do that in a scaleable and affordable manner, and the primary answer is low cost public debt–lending to middle income governments by high income governments at the rates that high income governments borrow themselves.

That's the basic model of multilateral development banking and it is why as a rule, multilateral bank loans are usually notably cheaper than market rates for most of their client countries.[7] The orange line crosses at Ghana's World Bank IBRD 20-year borrowing rate of 5.75 percent. Compare Ghana's cost of private debt for a solar project estimated at 23 percent. For Morocco the gap is 6 percent from the IBRD or 13 percent from the market. For India 6 percent and 11 percent.

7 The average multilateral loan in the African Debt Database in 2021 had an interest rate of 1.0 percent and maturity of 28 years. Unsubsidized IBRD terms at that point were closer to 2 percent (depending on country and international interest rates). In 2021 the yield discount between sovereign five-year USD-denominated bonds and the eight-year IBRD Flexible Loan was four to five percentage points (even) for countries including Egypt, Pakistan, Nigeria, and Kenya.

Figure 32. Comparing IBRD Lending Rates to Private Finance Rates



Sources: Selected countries from Gautam et al Cost of Capital for Renewable Energy Investments in Developing Economies Annex II World Bank IBRD loan pricing from WB Treasury, January 2023 SOFR from NY Federal Reserve

Each dollar of new multilateral bank equity can support $7 in direct lending in perpetuity. That suggests multilateral banks like the World Bank could sustain an additional $350 billion a year in mitigation related lending in perpetuity with about $50 billion a year over twenty years in additional capital, including about $30 billion of (currently-) ODA-eligible funding a year. That would help "flood the zone" for climate mitigation projects in the middle of the adaptation curve in middle income countries. The equity should, of course, be new and additional finance. (A less efficient alternative would be more bilateral lending by donor governments to achieve something similar).

The public finance approach not only better matches where resources for development and climate response are primarily needed—in the public sector, not the private sector—but is also far more affordable, scalable and efficient than the bespoke project-based approach of subsidizing private sector investments that donors have emphasized to date. It is by far the best way to demonstrably meet a $300 billion financing commitment in a way that doesn't eat ODA for the poorest countries and could actually make a difference to global progress on decarbonization.

That leaves development finance institutions that work with the private sector like the IFC as second fiddle: players but not stars. They could still do more—working more with national development banks to help roll out the private sector components of nationally determined contributions to the international climate effort. They could also move into large-scale operations in support of subnational borrowing to states and cities. Perhaps most importantly, rather than being a drain on grant resources that are ineffectively applied to development and climate challenges, they could focus on more profitable investments in richer countries in order to become a revenue source for ODA, re-reversing the recent reversal of financial flows between the IFC and IDA, for example.

Development Finance Institutions sit on a considerable stock of equity: the IFC, the European Bank for Reconstruction and Development, The Inter-American Development Bank's private sector arm and the UK DFI British International Investment between them alone have a stock of paid in capital and retained earnings worth about $76 billion. And those working in easier markets—the European and InterAmerican banks—already generate healthy returns from their investments, with a return on equity of five to six percent. Were DFIs to focus on making money in middle income countries (concentrating on low carbon investments and with some limits on projects that don't meet minimum quality standards), that $54 billion in capital might consistently generate $3 billion a year, which could be transferred to low income countries. Add in the private sector operations of other DFIs and the total could be considerably higher.

From a situation where bilateral donors are spending around $5 billion of ODA a year on private sector investments primarily in richer developing countries, we could move to a situation where DFIs are generating $4 billion or more in revenues for grants to poor countries—a net shift of perhaps $9 billion compared to current ODA to low income countries of about $22 billion.[8]

There are quality concerns to address with ODA and lending and DFI investments. Only one-third of current ODA is actually implemented by recipient institutions. Even financing that reaches those institutions is larded with restrictions, including on technologies. Not least, until the costs of zero carbon approaches become a lot lower and or international finance for climate and development gets magnitudes bigger, low income countries should get financing intermediate approaches like natural gas generation, to help cut the 3.8 million annual death toll from indoor air pollution.

Similarly, making climate mitigation lending more attractive will require shareholder support for process and bureaucracy change at the MDBs as well to improve approval and disbursement of financing. Energy lending should support an all of the above strategy including nuclear power, not least. Meanwhile, DFI operations should abide by the rules over competition and transparency in infrastructure investments that guide public sector donor financing.

Regarding the $300 billion goal, the official definition of climate finance decided by the OECD rich country club doesn't include any role for recipient countries in determining what counts. At the least, recipient countries collectively should have an equal say in determining what funded activities count toward climate finance goals. For mitigation spending in particular, it should probably have to be part of activities recipients have listed as a contribution to the UNFCCC process. I would also argue that mitigation finance should not count as ODA because it does not have "the promotion of the economic development and welfare of developing countries as the main objective" as suggested by the OECD rules.

8 In addition, by investing in more creditworthy countries, DFIs could increase the scale of investment at a constant equity level. The European and InterAmerican DFIs have an equity to assets ratio of 0.3 compared to twice that for the IFC and close to one-to-one for British International Investment. Were IFC and BII to move to a 0.3 ratio, that alone would allow for their portfolios to grow by a combined $60 billion.

A new model for cash-strapped times

The rich world could easily afford both more generous support to the poorest countries and more expansive support to mitigation projects in middle income countries. Instead, at immense cost to the future quality of life in rich countries and the present quality of life in poor countries, rich countries are skimping on both.

In this situation where rich countries are balking on their responsibilities, the world's poorest countries would be much better off with development finance continuing and a little more climate change in 2100 than no development finance and a little less climate change. And the worse you think the impact of climate change is going to be, the worse it is to take away aid from the poor countries that most need support for adaptation.

Furthermore, while climate is an urgent priority, it is also urgent that 16,000 children under the age of fifteen will die tomorrow largely because of easily preventable conditions. And again the day after, and again the day after. We can't solve climate by doing less about extreme poverty and premature death. But that's what the current system is pushing us towards. That, I think, is the most immediate crisis of climate and development finance.

The fix isn't to hope that the international private sector will provide cheap direct financing at scale for development and climate projects in poor, small economies. Decades of experience demonstrate it won't. Instead, we should ring-fence grant resources for the urgent development and adaptation needs of the poorest countries and use the considerable leverage of multilateral banks to support public financing at scale for mitigation and development finance in middle income countries. Thank you.

Annex Table: DFI Finances

	Equity (paid in capital and retained earnings)	Recent ROE (%)	Recent Capital Increases	ODA Share of Increase
IFC	37	1.5	5.5	3.9
EBRD	25	5.0	4.3	2.7
BII	11	1.4	4.4	4.4
IDB Invest	4	5.8	3.5	1.4
Sum	76		17.7	
Sum ODA	54			12.4
Average		3.4		

Sources: Capital, retained earnings, ROE IFC, EBRD, BII, IDB. DAC Coefficient.