BILL & MELINDA GATES foundation

Development Finance, Climate, and World Bank Reform

Jumpstarting Progress Toward the Sustainable Development Goals

The issues of multilateral development bank (MDB) reform and financing for climate and development are center stage this year with the appointment of a new World Bank president, important proposals for reforming the World Bank, and high-profile international gatherings including a June financing summit in Paris and the 2023 United Nations Climate Change Conference (COP28). The Bill & Melinda Gates Foundation's approach to reform of the World Bank—and the broader urgent need to expand funding to jumpstart the United Nations Sustainable Development Goals (SDGs) after multiple years of crises—is shaped by our 20-plus years of experience working with low-income countries, development banks, and a wide range of partners. We share our voice not as a representative of any country but as an advocate for basic human development. This paper spells out key actions that are needed to realize these much-needed reforms and mobilize enough resources to enable the poorest countries and poorest people to climb out of poverty despite repeated shocks and stresses.

A Uniquely Challenging Landscape

Two things are clear about development finance. First, the international system of aid and multilateral lending has contributed to historic improvements in the human condition over the past 25 years. Second, dramatic changes to this system are urgently needed to prepare for the next 25 years if we are to meet a new generation of challenges. In the current complicated global picture, no question is more vexing than how best to help poor countries adapt to the mounting impacts of climate change while still making progress on the vital work of promoting global health and development.

A confluence of factors has deeply complicated the traditional formulas for development. Multiple, overlapping shocks have buffeted low- and middle-income countries, leaving them with significantly fewer resources to respond to the lingering effects of the COVID-19 pandemic, the repercussions of the war in Ukraine, escalating food and fertilizer prices, high levels of inflation, growing debt and debt service obligations, and the mounting impacts of climate change. The World Bank notes that the pandemic "triggered the most pronounced setback in the fight against global poverty since 1990, and most likely since World War II."[1]

The pandemic also caused a massive, but often hard-to-see, collapse in human capital among young people, with the most severe fallout in the poorest countries. Nearly 1 billion children in low- and middle-income countries missed at least a full year of schooling during the pandemic, and those learning losses could reduce their collective future earnings by some US$21 trillion.[2] From 2019 to 2022, the number of undernourished people grew by as many as 150 million, which will affect everything from learning to future earnings.[3] Given that people's health and the skills and knowledge they accumulate over a lifetime are crucial to their economic prospects, the long-term impact of the pandemic on poor people around the world may dwarf its short-term costs.

Many low-income countries are now facing a terrible fiscal squeeze. Some 60% of low-income countries are at high risk of debt distress or are already in distress—twice the figure from 2015.[4] This is forcing low-income countries to make devastating tradeoffs between servicing their debt and making life-transforming investments in productive sectors such as agriculture and social service sectors such as public health. Debt service payments in countries eligible for assistance from the International Development Association (IDA), the World Bank's concessional lending arm, are estimated to have risen to more than US$62 billion in 2022—more than 10% of the value of their exports of goods and services—the highest proportion since 2000.[5] The G20 launched its Common Framework two years ago to facilitate debt restructuring in developing countries, but in practice the Common Framework process has been slow and cumbersome and ultimately of little use to countries: Only four countries have applied for relief through the framework to date.

This comes at a time when growth forecasts for sub-Saharan Africa—which accounts for about 60% of the world's extreme poor—are just 1.2% for 2023 and 2024, a rate that will not bring down poverty numbers.[6]

Across low- and middle-income countries already being buffeted by these multiple, overlapping shocks, we see a complex interplay between climate and development, which will only intensify in the coming years. The Horn of Africa is bracing for a fifth consecutive year of drought and all the resulting human suffering and displacement. Recent research published by the National Academy of Sciences suggests that climate change and its associated environmental impacts could triple the risk of extreme infectious disease epidemics in the coming decades.[7] Countries like Bangladesh are facing devastating flooding, the loss of valuable agricultural lands, and depletion of fresh drinking water supplies. Unless we help these populations address climate adaptation as part of their key health and development challenges, the world will not be able to meet its commitments to reducing global inequities, as spelled out in the SDGs.

A powerful and fundamental unfairness lies behind these numbers. Data from the World Inequality Lab indicates that in 2019, the poorest 50% of the world produced only 12% of global greenhouse gas emissions while suffering 75% of the relative income losses resulting from climate change.[8] Africa is especially vulnerable to climate change, with more than 60% of its population engaged in smallholder farming, most of them women, and most of them growing rainfed crops that are highly vulnerable to climate effects. The African Development Bank projects that economic losses from climate change, currently running at between US$7 billion to US$15 billion per year, will rise to US$50 billion annually by 2030, curbing economic growth by up to 15% in Africa.[9]

The Financing Landscape and Principles for Reform

Given these factors, it is not surprising that development finance, climate, and efforts to reinvigorate international financial institutions, particularly the World Bank, have rightly come to the fore.

Diverse actors are now advocating for reform from different perspectives. World Bank shareholders, including the United States, have pushed the bank to ensure that it is better equipped to deliver on its development mandate while rising to meet evolving global challenges, particularly climate change. In September 2022, the prime minister of Barbados, Mia Mottley, called for a sweeping overhaul of the global financial architecture to help vulnerable nations such as hers respond to climate change while promoting development, as part of what is now known as the Bridgetown Agenda. The G20 issued important recommendations through both its Eminent Persons Group on Global Financial Governance and its Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks. The UN Economic Commission for Africa has also called for urgent action on finance reform, particularly with regard to debt, and civil society organizations have been increasingly outspoken on the need for action.

In December 2022, the World Bank published its draft Roadmap for reform, and in February 2023 the United States nominated Ajay Banga to be president of the World Bank after the sudden departure of David Malpass in that role. Banga was confirmed in May 2023. Amid the growing chorus of calls for reforms to development finance, low-income countries have been increasingly vocal with their concerns that calls for increased funding for climate mitigation efforts could translate into less funding for core development needs at a time when progress toward SDG targets is badly lagging and domestic finances are highly constrained.

Finding a path forward will require understanding the contours of the current development finance landscape. International development finance and the architecture that supports it are far from monolithic. The broad umbrella term *international development finance* covers everything from public grant dollars flowing from the Global North to the Global South, to the global pooled funds of the international development banks, to development finance institutions and even private investors.

International financing also comes with different price tags, ranging from no- or low-cost assistance in the form of grants from traditional development bilateral donor agencies to highly concessional lending from the IDA. It also includes nonconcessional finance from bilateral creditors, including new creditors such as China. At the other end of the spectrum are loans with high market rates that obviously come with timebound or bullet repayment requirements. One example is Eurobonds, which have high interest rates but no preconditions, making them a sometimes attractive (but often risky) proposition for finance ministers. Countries across Africa have made strides in the past decade in securing better access to international capital markets, and the stock of African Eurobonds reached US$140 billion in 2021.[10]

Beyond these sources, countries can mobilize domestic private investment and raise government revenues. Countries in sub-Saharan Africa have made important progress in recent years in mobilizing more domestic revenues for development, but they still lag far behind high-income countries in that regard.

Even in better economic times, low-income countries have access to fewer sources of financing than do high- or middle-income countries, and they usually struggle to attract private capital at sufficient volume for their needs. Consequently, they remain significantly more vulnerable to the types of shocks that the global economy has experienced since the beginning of the pandemic.

In the past three years, all sources of financing—both domestic and external—suffered major hits. Government revenues fell due to the collapse in economic activity as well as measures introduced by many governments to reduce taxes to provide relief to consumers and businesses coping with the multiple crises. While it might be intuitive to assume that the world has been directing more funding to IDA and bilateral assistance to support hard-hit low-income countries amid the tumult of the past few years, that has not been the case. In 2022, net official development assistance (ODA) to sub-Saharan Africa declined by 7.8%.[11] One reason for this decline relates to changes in the rules that govern accounting for ODA over the past decade, which have led to increasing diversion of these funds to purposes other than economic development and poverty reduction in developing countries. For instance, donor countries can count spending on refugees during their first year in the country as ODA. In 2022, those costs made up more than 14% of ODA, representing some US$30 billion.[12] Similarly, donor contributions to IDA have declined in real terms over the past decade while the number of extreme poor living in IDA countries has held steady (at 450 million) and the number living in sub-Saharan Africa has increased (from 271 million to 389 million). In short, we are seeing a dwindling pool of funding available to achieve the SDGs at a time when such funding is most needed.

To add to this, rising inflation and corresponding rate hikes by advanced-economy central banks over the past year have priced most African economies out of the Eurobond market.[13] Commercial and bilateral lending to Africa increased dramatically from 2010 to 2019 but fell sharply in 2020 and 2021 and will likely be negative for 2022 and 2023. IMF and MDB lending made up for the sharp drop, but both are at risk of decline in the coming years without additional resources.[14]

It makes sense that some ministers of finance in sub-Saharan Africa and South Asia are arguing that the existing global financial architecture is simply not working. The debate about reform is not just about money—it's about impact. Before discussing the particulars of the steps ahead, we want to offer some fundamental principles that are informed by our foundation's values and by insights we have gleaned from our collaborative work in global health and development over the past two decades.

The priorities of low- and middle-income countries—those most in need of development progress—should remain central to a re-envisioned World Bank Group. Low-income countries are seeking greater investment in life-saving health programs and efforts to boost economic growth and productivity while simultaneously building resilience against climate change. Country-specific investments with the highest returns for poor people in low- and middle-income countries are in areas such as agriculture, energy, infrastructure, and human capital (including public health and women and girls) that promote greater equity and economic growth. In other words, low-income countries will understandably view climate adaptation through the broader lens of development, and donors and lenders should prioritize projects that maximize climate-resilient development outcomes. For the least developed countries, where CO_2 emissions are low but poverty is high, climate-resilient development and adaptation are a much higher priority than climate mitigation. And, as the Intergovernmental Panel on Climate Change has rightly noted, lack of development greatly compounds the risks associated with climate change.

Financing development—and climate adaptation—will require all kinds of capital, not just aid. An effective mix of grants, loans with varying degrees of concessionality, remittances, and private capital are all essential to addressing the current crisis. Highly concessional resources, which are the scarcest, should be directed to where they can have the greatest development impact and respond to the greatest needs and where no appropriate alternative is available. By that measure, IDA lending directed to the lowest-income countries and most vulnerable populations within them stands out as a clear priority, as is research innovation that benefits those same populations and where it is clear that the market will not act on its own. While the market can bring forward innovations to help mitigate climate change, and has done so in the past, it has largely not been involved in generating innovation for climate adaptation, which could benefit hundreds of millions of people—a classic market failure. Innovation to bring down green premiums will need some mix of public and philanthropic research dollars at an early stage, followed by investment capital. The most appropriate financing for climate change mitigation in developing country emitters—and energy transitions—will be through development banks and direct foreign investment, and this financing could reflect some modest concessionality relative to country-specific costs of capital.

More generosity is needed to revive progress. It will not be possible to preserve life-saving health programs, respond to the climate crisis, and address the record number of global refugees and displaced people if programs are pitted against each other in a zero-sum game. More resources are needed to achieve these goals. Low-income country leaders should not be placed in a position where they are forced to decide between vaccinating children and investing in drought-resilient crops.

Policies We Champion

In light of the above principles, our foundation strongly supports a number of actions to address the growing external financing gaps for low-income countries.

First and foremost, the twin goals of the World Bank—reducing extreme poverty to 3% by 2030 and improving the living standards of the bottom 40% of the global population—must remain at the core of its mission. Figuring out how to better integrate climate resilience with growth and development will contribute to achieving these goals. This will primarily mean adaptation for low-income countries and adaptation and mitigation for a mix of middle-income countries.

Achieving these goals will also require significantly more accessible and affordable development financing. Three elements are particularly critical:

- A surge in highly concessional financing, commensurate with the scale of low-income countries' financing needs, including a 50% increase in donor contributions to IDA and US$6 billion in immediate contributions to IDA's Crisis Response Window
- Improved mobilization of private resources through stronger efforts to improve domestic investment environments, the introduction of new and innovative financing approaches, and scaling up of existing blended financing models and instruments
- Significantly more decisive action to resolve the looming sovereign debt crisis

These elements will require, among other actions, the following reforms to the multilateral development finance system, including the World Bank.

- **Donors should begin mobilizing US$6 billion in immediate contributions to IDA's Crisis Response Window.** These contributions would allow IDA to maintain the same level of financial support to IDA-eligible countries in the last two years of the 20th replenishment of IDA and could potentially be finalized around the time of the World Bank Fall Meetings.
- **The initial round of reforms to the G20 Common Framework for debt treatment must be advanced immediately to facilitate debt restructuring in developing countries, introduce debt standstills upon a country's request for a debt restructuring, and begin making a portion of those debts financed at IDA rates.** We need a rapid review of the Common Framework and changes that will make it a workable option for developing countries.
- **IDA shareholders must make a collective commitment to increase IDA contributions by 50% and get donor contributions to IDA back to their real levels from a decade ago.** The World Bank's Roadmap places a great deal of focus on increasing lending to middle-income countries to address issues such as climate change mitigation and pandemics. Without a major infusion of new capital into the World Bank and IDA, such an approach would leave low-income countries further behind in their adaptation efforts and further expand the chasm of inequality. As part of the Roadmap discussions, shareholders should increase the amount of International Bank for Reconstruction and Development (IBRD) net income that is transferred to IDA and consider reinstating International Finance Corporation net income transfers to IDA.
- **Provide new money to the World Bank.** The bank cannot expand its mission without more resources. It is important to stress that institutions like the World Bank are *banks*. They lend money, and they get it back. Since 1944, the World Bank has taken in some US$19 billion from its shareholders and translated that into more than US$800 billion in lending. The MDBs all enjoy high credit ratings and are viewed as safe and stable as a result of their conservative lending practices. An agreement among them to negotiate a capital increase as part of the Roadmap process would not only step up financing capacity at this critical time but also shore up confidence in the multilateral system by signaling strong support from shareholders for the World Bank's model and the potential of reforms.
- **MDB shareholders and management should vigorously pursue options outlined in the G20 report on the MDBs' Capital Adequacy Frameworks to ensure that new and existing dollars go**

much further and make the World Bank more responsive to its borrowers. The G20 and others have rightly noted that "balance sheet optimization" would unlock considerably more lending power for the World Bank even with its existing resources (and even more so if it receives additional capital). In short, *balance sheet optimization* is banker lingo for changing how capital is managed in a way that would entail only a modest increase in risk while freeing up considerable funding. Other internal reforms, such as halving the time it takes to get a World Bank project started, would make a significant difference for borrowing countries that are frustrated by the bureaucratic complexities of World Bank lending.

- **Better differentiate pricing.** The World Bank's instruments may be too blunt for the needs of this moment. The bank cannot be everything to everyone, but it must have the tools to support differentiated priorities via differentiated pricing. Over the past decade, the bank has taken steps to differentiate pricing for its IDA and IBRD clients. For example, IDA clients may receive concessional loans or grants or a mix, depending on their risk of debt distress. IBRD clients receive different terms based on per capita gross national income and other factors. There is scope to extend the concept of pricing differentiation by sector. Human capital investments in IDA countries should receive the most concessional terms, projects with a strong public-good dimension should receive more favorable terms, and projects where private capital is an alternative should be structured to crowd in that capital—not replace it.
- **Accelerate mobilization of private capital for development.** Given the limited scale of ODA, private capital will be essential for the successful implementation of the overall development agenda. While the Roadmap highlights the important role of partnerships with the private sector, previous efforts in this area have delivered far less than promised. The World Bank and its shareholders need to take a hard look at why this has been the case and recognize that without some new ways of doing business and more efficient operations, the bank will continue to struggle to mobilize private capital on the scale that it hopes. The bank and its shareholders should develop a strategy that incorporates lessons learned from its cascade approach and from efforts like the IDA Private Sector Window. The strategy should outline clear improvements in the bank's engagement in mobilizing private capital, including the following.
    - **Adapt the operating model of the private-sector lending arms of MDBs.** Reinventing the wheel is unnecessary in this regard. Many reforms have already been proposed, including 1) adopting an originate-to-distribute model, 2) maximizing financial additionality by focusing on asset types that are undersupplied by private investors, 3) creating a strategy for improved mobilization of institutional investment, and 4) adopting transparent metrics and reporting on impact. Institutions that are part of the World Bank Group, such as the International Finance Corporation and the Multilateral Investment Guarantee Agency, will be crucial to addressing climate issues because they help leverage private money and can work much more effectively than currently.
    - **Address the failure of markets to crowd in the private sector.** Additional development financing is needed between the lowest-cost rates and market rates. Where there is money to be made and the risks are known and manageable, private-sector investors typically need no additional inducement. However, in many developing countries, information and regulatory gaps can hold back reasonably priced private-sector capital. In these circumstances, low-cost funds—from multilateral, bilateral, or philanthropic sources—can create timebound incentives for private investment. Programs that might fall in this category include middle-income country priorities such as investments in

energy transition, flood management, and more sustainable infrastructure with a commercial appeal. Because middle-Income countries usually have a more vibrant private sector, creating more opportunities for innovative financing is likely to be a meaningful solution. These moderately concessional loans are a good fit for high-impact projects in countries that have the capacity to take on debt, especially to support energy transitions in high-emitting middle-income countries.

- **Make agricultural adaptation and development a priority, given its centrality to climate-resilient development.** This effort should include a clear path to achieving the goal of doubling adaptation financing and an evidence-based global goal on adaptation to induce greater investment in a wider set of proven agricultural interventions. COP28 would be a good moment to secure donor commitments to increasing long-term agricultural research and development resources for small-scale producers, with a focus on increasing CGIAR financing by at least 10% annually beginning in 2023.
- **Rethink the Special Drawing Rights (SDR) system to put these resources to work for development.** Following the historic issuance of US$650 billion in SDRs in 2021, a campaign to reallocate US$100 billion in SDRs to lower-income countries has made significant progress toward the use of SDRs as a development finance tool. More work is needed to overcome technical hurdles to channeling SDRs through MDBs such as the African Development Bank; this has led to a viable proposal to reallocate SDRs through MDBs and identify other channels such as SDR bonds. Donors should explore every available option for channeling these resources, which are considered additional to traditional ODA, to countries that can use them to free up much-needed fiscal space. The G20 should launch a working group to rethink the SDR system, taking stock of the precedents set over the past two years, with the aim of addressing technical challenges and identifying innovative mechanisms for using SDRs.

Conclusion

The financing needs of the Global South are urgent and growing by the day. Development and climate are inextricably intertwined, and the ambitious SDG goals can be met only if the focus is on growth that is climate resilient, sustainable, and inclusive. This year presents the international community with a rare window for genuine reform and an opportunity to mobilize the resources needed to achieve these goals. We need to maintain constructive pressure across the multiple high-profile moments ahead—the Paris Summit, the World Bank Fall Meetings, COP28, and beyond—or we risk losing an entire generation of development progress.

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