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Building global prosperity

Proposals for sustainable growth

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Summary

— Plans for economic recovery after the COVID-19 pandemic create an opportunity to transform international development. Initiatives for 'building back better' should aim to galvanize investment in the developing world, with benefits for sustainability and societal resilience. This paper explores options for accelerating development and its financing in sectors such as public health, climate and digital infrastructure, in part by ensuring that relationships between donors and developing countries are more equitable and effective.

— The paper highlights a fundamental dilemma between the need for radical approaches and the recognition – given current geopolitical and economic headwinds – that incremental or technical changes may often be the most realistic way of advancing the development agenda. Accordingly, the contributors to this paper differ widely in their assessments of the prospects for international cooperation, and in the ambition of the principles and proposals for action they advocate. This reflects the reality that no single approach is suited to all contexts.

— Universal health coverage (UHC) and climate action exemplify this dilemma. At one extreme, the pandemic has strengthened the case for ambitious investments in UHC while confirming a dismaying lack of global solidarity in tackling big public health problems. With wealthy nations highly unlikely to provide enough money in the future, governments in the developing world will largely have to rely on domestic tax revenue to finance UHC or other health system improvements at a time when their budgets are severely strained. Yet the situation is not without hope: if the International Monetary Fund (IMF) amended its economic surveillance to include assessments of countries' health systems, this could encourage governments to pursue better policies in this area. A technical change of this nature would be particularly effective if accompanied by more flexible IMF definitions of sustainable government spending and debt, which could enable countries to invest more in public health without necessarily imperilling their creditworthiness.

— Similarly, tailored adjustments in financial market guidance and regulatory interventions could have an outsized impact on funding for climate action. One possibility would involve central banks adjusting their investment holdings to include more low- or zero-carbon assets, and to exclude carbon-intensive assets. This could encourage financial institutions to reweight their portfolios around sustainable investments, and help to accelerate the phase-out of investment in fossil fuels. More favourable collateral rules for such instruments

could stimulate lending into the net zero transition. For much of this to work, however, a globally consistent climate investment framework is needed to facilitate portfolio alignment with environmental standards.

- Other problems require more radical innovation. One is the inability of international financial institutions (IFIs) to raise sufficient climate investment. Reforming the structure of the IFIs to make them more effective (and representative of a diverse membership) is often discussed, but their capacity, ownership and staff culture are obstacles. A better option could be to start from scratch and design a specialized multilateral climate bank or 'climate finance institution': a CFI rather than an IFI, so to speak. Such an institution could deploy the partial paid-in capital and guarantee model of the World Bank, borrowing cheaply in the markets and leveraging this to raise higher multiples of capital.
- Beyond climate finance specifically, the need to find new ways of raising money is central to almost any discussion of development. Mobilizing private capital is paramount, with the G20 a potentially vital player in this area. A priority for the G20 should be to establish a new initiative for scaling up private development finance. This should focus, as in the past, on improving business environments and the bankability of investment projects in recipient countries. However, it needs to absorb the lessons from recent initiatives by engaging private sector expertise more fully and relying less on public institutional capital.
- The most important piece of the puzzle is the need to establish the culture and incentives for effective development cooperation. Progress on specific policy areas is contingent on closing the trust deficit that all too often inhibits development relationships. Developing countries sometimes resent what they perceive as intrusive 'conditionality' on the part of institutional lenders. Geopolitical competition between the US and China is also undermining efforts by these key donors to establish trust with developing countries. Insecurity and competition reduce the prospect for the US and China to align their programming so that developing countries can achieve key development objectives. Rebuilding trust and 'resetting' relations between donors and recipient countries will benefit from a strategy that emphasizes co-creation of development initiatives and establishes mechanisms for ensuring accountability.

Foreword

Jim O'Neill

In this project on 'building back better', we try to suggest ideas that might improve the structural performance of our economies, help societies develop peacefully, and enhance international policy delivery and governance, so that we might all enjoy more contented lives and be better prepared for the next crisis – presuming we can escape current challenges.

What is interesting and important about this era is that deeper issues seem not to have been dealt with from past crises, which means we need to address the legacies of those problems too in order to achieve sustainable post-COVID-19 economic recovery and development.

So not only do we have to find a way of getting beyond COVID-19 and somehow ending Russia's war in Ukraine, but we also need to deal with the apparent failings of international capitalism in recent decades, and make sure it works better for more of the world's citizens. Central to this project is the need to unleash private sector investment to fund action sufficient to tackle the toughest global challenges. Our policymakers and politicians also must be committed to the task. There is little point in coming up with clever-sounding initiatives if there is no political backing or intent to deliver.

We must do more to understand why, since the 2008–09 global financial crisis, recorded productivity in most advanced societies has slowed from its strong performance of the previous era. Generally weak private sector – and often, public sector – investment has been accompanied by low real wage increases. This is despite the fact that, until about a year ago, many international and domestic businesses were reporting strong profit growth while interest rates remained remarkably low – both variables that economic textbooks suggest should boost investment. Unless this conundrum can be fixed, it isn't credible to talk about 'building back better'.

Business CEOs often justify their firms' lack of investment by claiming that it reflects future uncertainties and pressure from shareholders not to waste precious capital. Yet if this argument were a genuine impediment to investment, policymakers could surely take steps to reduce uncertainty around decision-making where it is relevant to markets and corporate planning, or consider legislation making it more attractive for business to invest in both current operations and future opportunities.

Alongside this, governments should identify areas where their own investment might make a powerful direct contribution to economic development and societal resilience – and signal to business the degree of their belief in particular sectors. Combating climate change and developing infectious disease vaccines and treatments are two clear areas where such an approach might seem valid. In other words, policymakers must identify where genuinely important risk-taking is being undertaken in the search for solutions to global problems, and provide the right incentives and rewards accordingly.

Another central issue that connects the themes explored throughout this research paper is the state of globalization – and with it, international governance and our current global organizations.

Let me offer some of my thoughts in this arena.

Is it truly fair to promote the G7 as a mechanism for equitable global governance when this grouping includes Italy and Canada but not countries such as Brazil? Similar arguments could of course be made about India and China, and no doubt about other countries.

My original BRICs paper, entitled *Building Better Global Economic BRICs*, published in November 2001, came after the experience of the 1997–98 Asian economic crisis and the Russian currency crisis in 1998. These two events coincided with the emergence of China and Russia as more prominent players on the global economic scene.

It wasn't until 2008, and the global financial crisis, that an expanded version of my idea came into existence with the resurrection of the G20 and its new central role in global economics and finance. The BRIC nations – Brazil, Russia, India and China – joined other large emerging nations and a few other developed nations, in addition to G7 members, to transform the G20 into an influential forum for addressing the crisis. It was out of this initiative that the G7's long-standing Financial Stability Forum was supplemented by a new body, the Financial Stability Board. This allowed for true regular analysis of systematic risks globally emanating from the financial sector to be monitored regularly, and the arrangement has seemingly worked well since. After these apparent initial successes, and even until late into the last decade, the G20 appeared to have superseded the G7 as the more effective platform – taking a more complicated but also more representative role in global governance.

As we all know, this was not to last. As the 2010s wore on, the G20 started to lose its collective purpose. A number of factors contributed to this decline. They included the change in China's leadership and in perceptions of the direction of Chinese politics and policy, and of course the appearance in America of the Trump administration in early 2017. And then COVID-19 arrived on the scene. During the pandemic, the G20's ability to function collectively was sorely tested – as indeed was the case with many other global institutions, including the World Health Organization and the World Trade Organization.

This is all unfortunate, as it leaves the world without effective, truly international governance. As similar as the G7 members might seem, they account for 50 per cent of global GDP at most and fewer than 1 billion people.

We clearly must do better, and in this regard my input into this review is to identify global issues for which meaningful agreement and effective international governance are essential if fruitful solutions are to be found. It would seem quite clear that global health challenges, climate change, global economic imbalances and systematic threats are all such issues, and that whatever the efforts of the G7 – or, for that matter, the BRICS nations alone – these formats are insufficient to drive progress. The larger G20 needs to work better.

This brings me to the topic of globalization, and the fashionable idea that we have supposedly reached 'peak globalization' – however that might be defined. While economics is often considered the 'dismal' social science, it is reasonably scientific to argue that global trade benefits everyone, so long as national policymakers make sure the domestic fruits of trade are shared among their citizens. In this regard, many leaders seem to be unaware or have forgotten that since the early 1990s, until the COVID-19 crisis, hundreds of millions of people had been taken out of poverty by global trade and capital flows. Indeed, in the first two decades of the 21st century, the global economy grew at annual average rates of 3.9 per cent and 3.7 per cent respectively, faster than in the previous two decades when growth averaged around 3.3 per cent.

The problem is that, during this period of plenty, the 'winners' from globalization were a minority in many countries. They were often already the highest income earners and the wealthiest, while the 'losers' were displaced or challenged by the shifting of traditional industries to emerging nations. But the solution is not to retreat from open markets and prevent developing countries from leveraging trade to enable their citizens to join the global middle classes. Rather, it should be to help retrain workers and those most challenged by structural economic changes. In this, domestic policymakers must use fiscal policy to help reskill the workforce and boost productivity in their own countries.

Ultimately, we can and must build back better. We need to adopt stronger and clearer goals, motivate business with a sense of what I term 'profit with purpose', and recognize that we can only solve global problems through cooperation between those of different political and philosophical persuasions.

01 Introduction: crisis and challenge

The G7 democracies have launched a partnership for global infrastructure and investment, targeting investment in developing economies, but delivery has stalled. Inflation, domestic politics and, in Europe, an energy crisis are compounded by US–China rivalry and a climate of distrust between developed and developing countries. Can a turnaround be hoped for?

Leslie Vinjamuri
and Bernice Lee

Despite its better angels, and its aspirations to do more, the attempt by the Biden administration to galvanize support, both at home and with its G7 partners, to 'build back better' continues to face significant barriers. The original idea of such an initiative was to foster a sustainable post-COVID-19 economic recovery in low- and middle-income countries, focusing on areas such as climate resilience, healthcare, digital access and gender equality. But the global context has now become even more challenging. As pressures mount – higher food and fuel costs, extreme weather events, political unrest, rising interest rates – the demand by developing countries for debt relief, climate finance and greater investment grows even as the financial resources available become more constrained.

As we write, the prospect of a debt crisis is imminent, with around 54 countries in need of debt relief if they are to avoid extreme poverty and development setbacks and begin to tackle climate change.[1] Whether the current situation

1 Jensen, L. (2022), *Avoiding 'Too Little Too Late' on International Debt Relief*, Development Series Futures Working Paper, United Nations Development Programme, October 2022, https://www.undp.org/sites/g/files/zskgke326/files/2022-10/UNDP-DFS-Avoiding-Too-Little-Too-Late-on-International-Debt-Relief-V3.pdf.

becomes a systemic global debt shock is less clear. But whatever financial scenario unfolds in the next months, massive economic damage seems certain to occur – with sharply lower global growth, ruinously high inflation and huge social costs.

This in turn raises broader questions for international development cooperation. The current economic climate underlines the imperative for developing countries to construct effective and equitable partnerships with donors and secure reliable access to external financing. Yet relations between developing and developed countries are more fractious than ever. Trust between developing countries, private investors, and governments in the G7 and other advanced economies is missing, just when a new social contract that resets the terms of engagement is most critically needed.

Pressures in rich countries

The geopolitical context in which international development partnerships are being pursued is a significant barrier to their success. Domestic political support in the G7 countries for an ambitious global agenda has also come up short. Internal division and economic stress have diminished their room for policy manoeuvre. With anti-foreigner and anti-immigrant discourse pervasive across the West, this is not an obvious moment to mobilize support for what domestic electorates often perceive as expensive acts of altruism.

In the US, former president Donald Trump and Trumpism continue to dominate the Republican Party, and so political opposition to public spending on non-citizens has become more entrenched. This resonates at a time of high inflation and fuel prices, and among a population that has long assumed that the US government spends far more than it really does on international development. If a Republican returns to the White House in early 2025, this would likely undermine the potential for US leadership that is necessary to steward a global recovery and ensure progress on sustainable development. And almost regardless of the outcome of the 2024 US presidential election, further Republican influence in the US Congress is likely to add significant constraints to public spending on international development.

The current economic climate underlines the imperative for developing countries to construct effective and equitable partnerships with donors and secure reliable access to external financing.

In the UK and Europe, also, the outlook for development assistance is not good. An energy crisis in Europe could continue for two or three winters in succession, and has already impeded political support in the UK for funding a just, equitable and green recovery and economic transformation. Under Boris Johnson’s leadership, the UK cut its development aid and released a development strategy more focused on trade and investment than on poverty relief or development.

The UK is now spending an increasing share of its development assistance budget at home rather than abroad,[2] and its commitment to foreign aid could plummet to a mere 0.3 per cent of gross national income.[3] The current economic crisis means that a return to higher levels of assistance is unlikely anytime soon.

Moreover, the wider global environment in which to finance and deliver foreign aid is only likely to become *more* challenging. The prospect, and in many developed economies the reality, of recession and the reduction of estimates for economic growth worldwide will make it more difficult to raise money, and to overcome the trust deficit between rich countries and developing ones. In October, the International Monetary Fund (IMF) cut its forecast for global real GDP growth in 2023 to 2.7 per cent from an earlier projection of 2.9 per cent in July. In contrast, global growth set a rapid pace of 6 per cent in 2021 (albeit off a very low base).[4] Why does this matter? As the old saying goes, charity begins at home, and this is the attitude voters in developed countries are likely to adopt if a recession, or even just a sharp slowdown, occurs. 'For many countries, recession will be hard to avoid,' said David Malpass, the president of the World Bank, in June 2022 at the time of the bank's own growth estimate reductions.[5]

Pressures in developing countries

A slowdown in significant and systemic parts of the global economy also presents both short- and longer-term difficulties for developing countries. The immediate issue is one of stabilization: public finances, already weakened by a build-up of debt in the decade before COVID-19, have come under further pressure from the direct and indirect economic effects of the pandemic. One in every five developing countries is undergoing 'significant fiscal and financial stress', according to a group of experts that met recently in Barbados. Rising global interest rates could worsen matters, making future borrowing more expensive for emerging market governments, and forcing them to allocate more of their limited budgets to servicing existing debt.[6]

These challenges are exacerbated by the inflationary fallout from Russia's war in Ukraine, with the conflict's impact on food and energy supplies contributing to sharply higher prices for basic commodities. 'The world is on the brink of the

2 ITV News (2022), 'More of UK's aid budget spent inside UK than in poor countries overseas, experts say', 29 October 2022, https://www.itv.com/news/2022-10-28/more-of-uks-aid-budget-spent-inside-uk-than-in-poor-countries-experts; and Hughes, S. and Mitchell, I. (2022), 'Projections of UK-Hosted Refugees, and the Implications for the UK's Aid Budget and Spend', Center for Global Development, 26 September 2022, https://www.cgdev.org/publication/projections-uk-hosted-refugees-and-implications-uks-aid-budget-and-spend.
3 Worley, W. (2022), 'Fears abound that UK aid budget could be slashed to 0.3 percent', Devex, 19 October 2022, https://www.devex.com/news/fears-abound-that-uk-aid-budget-could-be-slashed-to-0-3-percent-104191; and Baker, P., Mitchell, I. and Regan, L. (2022), 'How Many Lives Will the UK's Aid Budget Reduction Really Cost?', blog post, Center for Global Development, 24 October 2022, https://www.cgdev.org/blog/how-many-lives-will-uks-aid-budget-reduction-really-cost.
4 International Monetary Fund (2022), *World Economic Outlook: Countering the Cost-of-Living Crisis*, October 2022, https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022#Overview.
5 World Bank (2022), 'Stagflation Risk Rises Amid Sharp Slowdown in Growth', press release, 7 June 2022, https://www.worldbank.org/en/news/press-release/2022/06/07/stagflation-risk-rises-amid-sharp-slowdown-in-growth-energy-markets.
6 Douglas, J., Hayashi, Y. and Delaney, C. (2022), 'Rising Inflation and Interest Rates Heap Pressure on Emerging Markets', *Wall Street Journal*, 18 June 2022, https://www.wsj.com/articles/rising-inflation-and-interest-rates-heap-pressure-on-emerging-markets-11655544600.

most severe cost-of-living crisis in a generation,' according to Rebeca Grynspan, secretary-general of the United Nations Conference on Trade and Development. 'The FAO food price index is at historic heights, and hundreds of thousands of people are already facing famine as a result.'[7] This only makes the establishment of a new strategy for international assistance and development more urgent.

Yet if anything, the longer-term picture is even more concerning. The more resources developing countries must devote to economic 'firefighting', the less room for manoeuvre they have to tackle underlying development needs. The threat is not just that a global recession 'will spare no one, [and] lead to more poverty and hunger' but that it will 'delay the transition to a sustainable future'.[8] With few exceptions, developing countries have not adopted redistributive and transparent development models that can meet the long-term needs and demands of their populations.

As a result of all these factors, the overall process of assistance and development is at a critical juncture.

The foreign aid conundrum

With this context in mind, this multi-author research paper examines some of the fundamental challenges to development cooperation and proposes solutions for meeting them. It frames the research question around the concept of 'building back better' – reflecting the expression initially used by the G7 for a post-COVID-19 recovery programme launched in mid-2021.[9] Within this broad topic, our contributors analyse multiple different dimensions to foreign aid and development cooperation, ranging from donor–recipient tensions to climate finance to the role of the G20.

The essential dilemma we seek to address is how to conceive of development investment and assistance in ways that are adapted to shifting political and economic currents, while avoiding (among other issues) the unpopular 'conditionalities' of past donor funding. A global recovery will require public leadership and a heavy dose of private investment, but it will also require careful management of geopolitical competition, overcoming a North–South trust deficit, and rethinking standard practices in the existing development institutions.

Part of this challenge is the need for donors to respect the agency of aid recipient nations without moving to an unchecked system in which vested interests and local elites can secure funding (and dominate its distribution) without sufficient transparency. Any new model of development assistance must have more effective – yet visibly equitable – arrangements for responsible and accountable stewardship of funds.

7 United Nations Conference on Trade and Development (2022), 'Trade and Development Board, sixty-ninth session: Opening segment', 20 June 2022, https://unctad.org/osgstatement/trade-and-development-board-sixty-ninth-session-opening-segment.
8 The Bridgetown Initiative (2022), 'High-Level Retreat on a Global Financial Architecture for a World facing Global Shocks', 30 July 2022, p. 1.
9 The White House (2021), 'FACT SHEET: President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership', press release, 12 June 2021, https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/12/fact-sheet-president-biden-and-g7-leaders-launch-build-back-better-world-b3w-partnership.

A spectrum of solutions

Perhaps inevitably, given the daunting scale of the development challenges, our contributors propose ideas that span a wide spectrum of ambition – from pragmatic technical measures to more fundamental reforms. In Chapter 2, Creon Butler, Rob Yates and Tim Benton explore first principles for a sustainable recovery. Respectively, they observe that economic policy cooperation should focus on issues where consensus is strong and the challenge can be framed in a politically low-profile manner; call for universal health coverage to be prioritized in domestic public spending; and underline the need for a reimagined environmental capitalism that respects planetary boundaries. Jim O'Neill, former chair of Chatham House, also proposes that the IMF adopt a more flexible definition of fiscal sustainability in its economic assessments of member countries, and that its Article IV surveillance encompass a review of national health systems.

Chapter 3 covers the increasingly confrontational geopolitics of foreign aid, with Bernice Lee and Cynthia Liao stressing that US–China competition threatens to undercut the potential of development assistance in developing countries. The authors call for greater alignment between these major powers, and propose tactics for how developing countries can better position themselves to manage this competition.

The need to leverage limited public sector funds is a recurring theme throughout this paper, and in Chapter 4 Creon Butler and Theo Beal extract lessons for the current period from previous G20 initiatives to mobilize private finance for development in Africa and beyond.

In Chapter 5, Rebecca Christie looks at the diminished status of the 'Washington consensus', the proliferation of development banks, and the implications of these trends for conditionality – both in international lending to developing countries and in the financial architecture more broadly.

In Chapter 6, Lilia Caiado Couto considers proposals to enhance climate finance, identifying the need for common global definitions of low-carbon assets so that institutional investors can reweight their portfolios around sustainability, while Mark Malloch-Brown thinks a shortage of climate funding from international financial institutions (IFIs) could be addressed through the creation of a 'climate finance institution' – a kind of CFI rather than an IFI, as it were.

In Chapter 7, Marianne Schneider-Petsinger looks at the digital sector. She sets out the scale of global inequality in terms of access to the internet, and proposes mechanisms for securing greater commitments in this arena.

And in Chapter 8, Mark Malloch-Brown and Leslie Vinjamuri offer a dose of realism about the contemporary challenges the developing world faces. The authors propose strategies for building the trust between donors and recipients that is essential if private capital is to be mobilized at scale in advancing key development objectives.

Box 1. 'Building back better' – a call for solidarity

Rt Hon. Helen Clark
President of Chatham House, former prime minister of New Zealand

Our world is beset by a series of compounding and intersecting crises, from the COVID-19 pandemic to the increasingly evident climate emergency, to a high incidence of armed conflicts driving death, destruction and mass displacement. These crises in turn are deepening poverty, inequalities and marginalization for communities and countries with the least capacity to mitigate the impacts.

The jury is out on whether recovery from these crises is even possible in the current geopolitical context. Yet the alternative is bleak, offering a future of a divided world which cannot advance the ambitious agendas, agreed in 2015, for the Sustainable Development Goals, the Paris Agreement on climate change, the Sendai Framework for Disaster Risk Reduction, and the Addis Ababa Action Agenda on Financing for Development.

To attempt recovery, we need a 21st-century version of the Marshall Plan to invest in the capacities and infrastructure critical to human and sustainable development. In turn, that would help build the trust required for more effective international cooperation. Trust has been sorely undermined both by the inequitable COVID-19 response – which denied low- and middle-income countries timely access to the commodities needed to fight the pandemic – and by the ongoing failure of developed countries to provide funding pledged to developing countries for climate action.

United Nations processes have provided us with the vision and the agendas for building a more inclusive and sustainable world, but those processes alone do not drive implementation. The G20 – representing some 85 per cent of world GDP and including both developed and emerging economies – must see its role as being to mobilize the means of implementation, in full consultation with developing countries. All available sources of finance must be used: public and private, developmental and environmental.

What can be termed the 'software' of development must be funded too – to build effective and transparent institutions of governance, and to combat corruption and illicit financial flows. Far more attention must be paid to the need for risk-informed development. Without this critical component, we face the prospect of development progress being reversed yet again by more pandemics and climate-related and other disasters, which better preparation might otherwise have prevented and/or mitigated.

Guiding all our efforts must be a vision of a world in which every human being can realize their potential, have access to essential services, live full and fulfilling lives in clean and peaceful environments, and have their human rights upheld. We are far from achieving that dream at present, yet we know that with international solidarity, we can advance towards it. This is not a task for future generations. It is up to today's leaders to accept their responsibility to work across geopolitical divides to secure a decent future for all of humanity and for our planet.

02
First principles for a sustainable recovery

What does it really mean to 'build back better' after COVID-19? Our experts advocate both pragmatic and aspirational approaches, including international action on sovereign debt, domestic action on universal health coverage and a shift to more sustainable economic models.

Creon Butler, Rob Yates and Tim G. Benton

The economic governance perspective: three principles for policymakers

Creon Butler

It will be some time before we have a full understanding of the extraordinary nature and scale of the global economic shock caused by the COVID-19 pandemic.

Some immediate facts are known. World GDP fell by an unprecedented 3 per cent in 2020,[10] and while it bounced back sharply in 2021 as restrictions on movement and public gatherings were lifted, the pandemic has left a long-term legacy of higher debt across a range of countries. Average gross public debt in advanced countries was *up* 14 percentage points to 118 per cent of GDP at the end of 2021,[11] while in the developing world there was

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10 International Monetary Fund (IMF) (2022), *World Economic Outlook: Countering the Cost-of-Living Crisis*, p. 125, https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022#Overview.
11 IMF (2022), *Fiscal Monitor: Helping People Bounce Back*, Table A7, p. 50, October 2022, https://www.imf.org/en/Publications/FM/Issues/2022/10/09/fiscal-monitor-october-22.

a sustained rise in the number of countries in, or near, debt distress (60 per cent of low-income countries and 30 per cent of emerging economies by the summer of 2022).[12]

The direct effects of the pandemic may continue for some time. China's delayed relaxation of its 'no COVID-19' policy means that the virus is still a major drag on the world's second largest economy – with Chinese GDP declining 2.7 per cent in the three months to June 2022 before recovering by 3.9 per cent in the subsequent quarter[13] (and overall growth of just 3.2 per cent projected by the International Monetary Fund for 2022).[14] Moreover, anecdotal evidence and initial empirical studies suggest that, even where the virus has stopped disrupting day-to-day life, the impact on productivity and future public spending from the prolonged interruption in normal schooling over 2020–21 and the effects of 'long COVID' may prove a significant drag on growth in some countries for years to come.

This uncertainty makes devising an appropriate plan to rebuild the world economy (or 'build back better') in both advanced and developing countries far from straightforward. We have already seen the kind of problems that can arise. With the benefit of hindsight, and in the light of the current inflation surge, it looks like monetary and fiscal policy in the advanced economies was much too loose in the second half of 2021. Correcting this through a sharp rise in US interest rates has been one of the factors leading to the deterioration in the sovereign debt situation of low-income and emerging economies.

Judging the response is also greatly complicated by Russia's full-scale invasion of Ukraine in early 2022, and by the rapidly crystallizing existential threat from climate change. Russia's attack on Ukraine and its subsequent retaliation against the EU following G7 sanctions have led to extreme short-term disequilibrium in global energy markets, with natural gas prices in Europe at the end of August exceeding the equivalent of $500 per barrel of crude oil before falling back to approximately $220 currently.[15] Similarly, the unprecedented sanctions taken by the West to weaken Russia's ability to continue the war are likely to have substantial long-term consequences for the international economic system.[16] Meanwhile, the radical reshaping of global investment required to transform the world economy to 'net zero' by 2050 creates a need for strong government interventions which have only just begun to take shape. According to one estimate, total *additional* investment needs for the world to achieve net zero emissions of greenhouse gases are of the order of $1 trillion to $3.5 trillion per year (between 1 per cent and 3.6 per cent of 2021 GDP).[17] The dilemma for Western governments which must choose between spending in support of Ukraine

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12 IMF (2022), 'IMF Managing Director Kristalina Georgieva Urges G20 Leadership to Address 'Exceptionally Uncertain' Global Outlook', press release, 16 July 2022, https://www.imf.org/en/News/Articles/2022/07/16/pr22261-md-g20-statement.
13 Trading Economics (2022), 'China GDP Growth Rate', https://tradingeconomics.com/china/gdp-growth (accessed 23 Nov. 2022).
14 IMF (2022), 'Latest World Economic Outlook Growth Projections', 11 October 2022, https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022#Projections.
15 Trading Economics (2022), 'EU Natural Gas', https://tradingeconomics.com/commodity/eu-natural-gas (accessed 23 Nov. 2022).
16 Butler, C. (2022), 'Sanctions Change Everything', *The World Today,* June and July, Volume 78, No 3.
17 McKinsey & Company (2022), *The net-zero transition: What it would cost, what it could bring*, January 2022, https://www.mckinsey.com/business-functions/sustainability/our-insights/the-net-zero-transition-what-it-would-cost-what-it-could-bring.

(ultimately critical for national security) and contributing to global development finance (critical to averting climate disaster) highlights the kinds of complexities policymakers now face.

In these circumstances, *three* principles should guide the *current* approach of policymakers to building back better. These principles recognize the urgency of the challenges, but also the limits on institutional capabilities and the constraints imposed by populist politics and geostrategic tensions.

First, as far as possible, policies should be devised to **use the implementation tools and institutional mechanisms we *already* have available**, or which can be adapted relatively easily to new purposes. We are in an extraordinary situation, and it is true that a crisis can sometimes open up new opportunities for reform, but this does not change the very limited bandwidth of policymakers, or the fact that building new institutions from scratch takes time and can have unintended consequences.

Two of the clearest priorities for building back better should be the relatively small-scale investment required for pandemic preparedness and response and, on a much larger scale, boosting renewable energy investment as a direct response to the escalation in hydrocarbon energy prices.

Second, policymakers should **rigorously prioritize** – they should do *first* the things for which the evidential basis is clearest and which can hit several objectives with one policy. They may also need to split major problems into smaller/incremental steps. Thus, two of the clearest priorities for building back better should be the relatively small-scale investment required for **pandemic preparedness and response** and, on a much larger scale, **boosting renewable energy investment** as a direct response to the escalation in hydrocarbon energy prices, particularly for natural gas in Europe.

Third, and perhaps most important, policies should recognize, and adapt to, the current **very serious political constraints on global cooperation**. Global governance is currently under considerable strain, and the seriousness of the challenges humanity faces does not change that. Today's international community is very different to the one that responded to the global financial crisis more than a decade ago. Trust has eroded, and political and economic philosophies are far more disparate – particularly on issues such as the role of the private sector. The situation is partly a consequence of Russia's invasion of Ukraine (and the disagreements between the West and leading emerging economies on whether Russia should be suspended from the G20). But it also reflects longer-standing and increasing tensions between the West and China, with the former tending to reassess China as a strategic threat and China perceiving almost any Western proposal as designed to prolong what it sees as the West's disproportionate influence on the international economic architecture. At the same time, the West is unwilling to carry a disproportionate share of the costs (relative to GDP) of tackling global problems.

In these circumstances the **best response is to focus** – in the G20 and other global forums – on issues where there is the strongest consensus on the need for international cooperation between the West and emerging economies (particularly China), where the challenge can be framed to a large extent in a technocratic, politically low-profile manner, and where Russia's natural role is limited. A good current example of this is the response to the **escalating sovereign debt crisis in low-income and emerging economies**.

While these principles may not lead to highly visionary or inspiring initiatives, they are a realistic response to today's policy environment. If applied systematically, the results may be faster and more significant than the alternative of a much higher-profile and ultimately unsuccessful strategy, and could provide the building blocks for a comprehensive response to the world's most pressing problems.

The public health perspective: using 'build back better' investments to promote universal health coverage

Rob Yates

Recognizing that policies and activities in multiple sectors affect health outcomes,[18] what is the best contribution the **health sector** can make to 'building back better'? Since the advent of the Sustainable Development Goals (SDGs) in 2015, there has been a consensus among global health policy experts that attaining universal health coverage (UHC) – SDG target 3.8 – should be a focus of health systems worldwide.[19] Indeed, this was the theme of a special high-level meeting of heads of government before the UN General Assembly in September 2019, which proved to be the eve of the COVID-19 pandemic.[20]

Looking back over the past three years and the failures of national and multilateral health systems to protect the world's population from a global health shock, it is all too apparent how far the world is from UHC. Even the most sophisticated health systems have exhibited alarming gaps in coverage of key services for their most vulnerable populations.[21] The ongoing inequitable distribution of vaccines and other commodities has demonstrated a lack of solidarity by wealthy nations in ensuring that essential services be allocated globally according to need[22] – one of the key principles of UHC.

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18 Marmot, M. (2005), 'Social determinants of health inequalities', *The Lancet*, 19 March 2005, https://www.thelancet.com/journals/lancet/article/PIIS0140673605711466/fulltext.
19 Adhanom Ghebreysus, T. (2017), 'All roads lead to universal health coverage', *The Lancet Global Health*, 17 July 2017, https://www.thelancet.com/journals/langlo/article/PIIS2214-109X(17)30295-4/fulltext.
20 United Nations (2019), 'Political Declaration of the High Level Meeting on Universal Health Coverage', 23 September 2019, https://www.un.org/pga/73/wp-content/uploads/sites/53/2019/07/FINAL-draft-UHC-Political-Declaration.pdf.
21 Berger, E. (2022), ''Failure of an American ideology': why Covid has an outsized impact on the US', *Guardian*, 15 May 2022, https://www.theguardian.com/us-news/2022/may/15/us-public-health-healthcare-covid-society.
22 Rahman-Shepherd, A. et al. (2021), *Solidarity in response to the COVID-19 pandemic: Has the world worked together to tackle the coronavirus?*, Research Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2021/07/solidarity-response-covid-19-pandemic.

These failings have strengthened, rather than undermined, the case for UHC. The externalities associated with infectious diseases have highlighted the need for **universal** coverage of key services – especially public health services that prevent and control epidemics. The devastating economic impact of the pandemic has also strengthened the economic case for investing in health services: the World Bank, IMF and World Trade Organization (WTO) have joined the World Health Organization (WHO) in calling for investments of billions of dollars – to save trillions of dollars worth of output that would otherwise be lost.[23] Furthermore, the impact of the pandemic has generated political pressure worldwide to strengthen health systems. In 2020 a huge UN survey, involving over 1 million respondents, found that improving access to healthcare was by far the most popular request.[24]

So if the health, economic and political cases for accelerating universal health reforms have never been stronger, how will such reforms be financed? Answering this question also involves acknowledging that only public financing mechanisms can achieve the overall objective of UHC, whereby everyone receives all the health services they need without suffering financial hardship.[25]

Given the record of wealthy nations in underfunding global health financing mechanisms during the pandemic, it is unrealistic and naive to think that their behaviour will change now, and that they will play a significant role in financing universal health reforms in the developing world. Instead, we should be looking for governments to increase their own *domestic* public spending on health using funds primarily sourced from general taxation. The reforms in IMF accounting rules proposed by Jim O'Neill in this edition would facilitate this process.

The ongoing inequitable distribution of vaccines and other commodities has demonstrated a lack of solidarity by wealthy nations in ensuring that essential services be allocated globally according to need.

But what is the likelihood of this happening in a world grappling with new crises associated with the war in Ukraine, rising energy and food prices, and the ongoing climate crisis? Actually history would suggest that the chances are quite good, given that so many of the world's most famous universal health systems have emerged out of previous crises.[26] Examples include systems in the UK, France and Japan after the Second World War, in New Zealand after the Great Depression, and in Thailand in 2001 following the Asian financial crisis of 1997–98. There

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23 IMF (2021), 'New $50 Billion Health, Trade, and Finance Roadmap to End the Pandemic and Secure a Global Recovery', press release No. 21/150, 1 June 2021, https://www.imf.org/en/News/Articles/2021/06/01/pr21150-new-billion-health-trade-finance-roadmap-end-pandemic-secure-global-recovery.
24 United Nations (2020), *The Future We Want, The United Nations We Need*, https://www.un.org/sites/un2.un.org/files/2020/09/un75report_september_final_english.pdf.
25 World Health Organization (WHO) (2010), *The World Health Report 2010: Health systems financing: the path to universal coverage*, https://www.who.int/publications/i/item/9789241564021.
26 McDonnell, A., Urrutia, A. F. and Samman, E. (2019), *Reaching universal health coverage: a political economy review of trends across 49 countries*, ODI Working Paper 570, https://cdn.odi.org/media/documents/200623_uhc_paper_final.pdf.

is also the example of China, which trebled its public health spending in the aftermath of the SARS crisis in 2003.[27] Indeed, there are already examples of countries indicating that they will be launching or accelerating major universal health reforms in response to recent crises; these countries include Malaysia[28], Egypt[29] and South Africa.[30]

So might one of the few silver linings in the crises of the 2020s be that more political leaders implement domestically financed universal health reforms? This would bring immediate health and economic benefits to their countries, and history shows that it could bring them significant political benefits – enabling them to stay in power and implement the other policies required to 'build back better' in their own countries.

Box 2. How IMF Article IV reforms and tax incentives can support 'building back better'

Jim O'Neill
Former chair of Chatham House; vice-chair of Northern Powerhouse Partnership

Two specific ideas for 'building back better' have grown in my mind in recent years.

The first concerns how governments present and budget for spending on public goods (and indeed how the international system recognizes and accounts for such spending). Specifically, I believe governments should consider dividing their health budgets more transparently into categories for investment spending and current/maintenance spending respectively. Otherwise, how do we ensure that countries can truly commit resources to preparing for the next pandemic or another international health crisis – such as one prompted by a rise in antimicrobial resistance (AMR)?

Central to this idea is the need to persuade the International Monetary Fund (IMF) to adjust its Article IV surveillance process to include an assessment of member countries' health systems as part of its regular due diligence. The IMF would not necessarily need to develop its own health analytics, but could draw on analysis from the World Health Organization (WHO) and indeed motivate WHO to strengthen this aspect of its work. The Article IV series is highly influential in markets and with governments, and the introduction of health analytics could encourage countries to pursue better policies in this area. IMF officials may protest that their expertise is not in public health, but COVID-19 demonstrated that a health crisis can threaten the IMF's core remit of maintaining macroeconomic stability. In other words, the IMF either needs to acquire the necessary expertise itself or obtain technical support from other international bodies such as the World Health Organization (WHO) or the World Bank.

27 WHO (undated), 'Health financing in China', https://www.who.int/china/health-topics/health-financing.
28 Jamaluddin, K. (2022), 'MOH's white paper: A vision to future-proof M'sian healthcare', Malaysiakini, 15 August 2022, https://www.malaysiakini.com/columns/632173.
29 Kadry, A. (2022), 'Egypt to implement healthcare system nationwide within 10 years: Finance minister', ahramonline, 24 July 2022, https://english.ahram.org.eg/News/472012.aspx.
30 BusinessTech (2022), 'Government using Covid-19 as a jump pad for the NHI: minister', 11 May 2022, https://businesstech.co.za/news/government/585360/government-using-covid-19-as-a-jump-pad-for-the-nhi-minister.

More broadly, IMF thinking on the appropriate levels of government spending and debt also needs to be transformed. A macroeconomic approach that incorporates the revised division of spending categories and more flexible definitions of fiscal sustainability could give IMF member countries room to be more ambitious in meeting their own health investment needs – or indeed in tackling other strategic challenges such as responding to climate change. This could help 'unfreeze' policymaking in developing countries, where the rigidity of the post-war IMF multi-decade accounting frameworks for government finances often deters growth- and resilience-enhancing investment. At a minimum, the IMF's board should undertake an in-depth study as to why this approach cannot be considered.

The second idea for building back better is how to address the private sector's apparent timidity in investment spending. I have come to believe that the core constraint here is how prevailing risk–return parameters in financial markets incentivize corporate decision-making, for example by encouraging share buybacks in preference to productive investment. One answer would be for policymakers to change the risk–return calculation for CEOs of publicly listed firms by making share buybacks less tax-efficient. This could be done through legislation, and possibly just by raising the marginal tax rate on share buybacks. Alternatively, new guidance could permit buybacks only when they are objectively demonstrated to have a positive impact on productivity.

To give an example from the healthcare sector, I discovered while chairing an independent global review into AMR for the British government under David Cameron that the amount spent by the three leading US pharmaceutical companies between 2010 and 2015 on buying their own shares exceeded the total cost of 29 measures we had proposed to address AMR – these were recommendations that could prevent AMR from potentially killing 10 million or more people a year, and costing the world economy $100 trillion in terms of lost opportunity. Surely such companies must be encouraged to become more committed to AMR drug discovery and production, or indeed to the development of vaccines and other essential drugs? Similar scenarios can easily be imagined for other industries: for example, should fossil fuel energy producers be allowed to pursue major share buyback programmes instead of investing in alternative energy at a faster pace?

Instead generous incentives, including tax breaks, could be offered to private companies to invest in societally valuable investments. For instance, companies developing antibiotics could get lower tax rates. I am a strong believer in tax incentives for genuine risk-taking investment, even if many start-up businesses ultimately fail. Favourable tax treatment in targeted instances certainly seems worthier than the push for lower corporate taxes. The evidence of the past 20 years suggests lower corporate taxes have not led to greater investment.

The environmental perspective: how do you 'build back better' sustainably?

Tim G. Benton

The past 10 years or so have been characterized by a multitude of climate-related crises. In 2010 an extreme heatwave in Eastern Europe resulted in rapid food price inflation. This laid the ground for civil unrest and riots in many countries around the world, which in turn helped to spark the Arab Spring, leading to increased migrant flows into Europe and contributing to a rise in nationalism.[31] Throughout the decade, droughts, floods and wildfires wreaked havoc as the direct impacts of climate change became more palpable. Pest outbreaks – for example, of locusts – also became more common as the ecological impacts of climate change started to become evident.[32] Some combination of land-use change and climate change almost certainly made the emergence of SARS-CoV-2 more likely, and with it the COVID-19 pandemic.[33]

These direct and indirect environmentally induced hazards lead to cascading and systemic risks that reverberate around the world. Supply chains, financial flows, movements of people, and social and political stability are all affected.[34] Ultimately, the risks are growing every year through unsustainable resource extraction and use, in turn underpinned by unsustainable patterns of consumption. The problem is amplified by increased global interconnectivity, with the result that a hazard arising in one place can affect sectors and geographies unrelated to the original hazard.

Unless humanity acts urgently and ambitiously to adapt to and mitigate the environmental risks, crisis will follow crisis, increasing in frequency and magnitude, so that every economy will have to focus on tackling and recovering from successive emergencies – rather than having the policy 'headroom' to be more strategic about development. Despite abundant evidence, accumulated over the last decades, of the need to act, we are missing opportunity after opportunity to build a better, more resilient, more sustainable world. Times of crisis also provide an opportunity for change, as 'business as usual' gets disrupted and some of the locked in features of incumbent systems get loosened. However, following the global financial crisis of 2008–09, the collective focus was not on 'building back better' but on 'building back business as usual as fast as possible'. The same has been true – so far – of the COVID-19 pandemic.

31 Challinor, A. J., Adger, W. N., Benton, T. G., Conway, D., Joshi, M. and Frame, D. (2018), 'Transmission of climate risks across sectors and borders', *Philosophical Transactions of the Royal Society A: Mathematical, Physical and Engineering Sciences*, 376(2121), 30 April 2018, https://royalsocietypublishing.org/doi/10.1098/rsta.2017.0301.
32 Pörtner, H.-O. et al. (2022), 'Climate Change 2022: Impacts, Adaptation and Vulnerability', *IPCC Sixth Assessment Report*, Intergovernmental Panel on Climate Change, 27 February 2022, https://www.ipcc.ch/report/ar6/wg2.
33 Lawler, O. K. et al. (2021), 'The COVID-19 pandemic is intricately linked to biodiversity loss and ecosystem health', *The Lancet Planetary Health* 5.11 (2021): e840-e850.
34 Challinor, A. and Benton, T. G. (2021), *Technical Report Chapter 7: International Dimensions,* UK Climate Risk Independent Assessment (CCRA3), https://www.ukclimaterisk.org/wp-content/uploads/2021/06/CCRA3-Chapter-7-FINAL.pdf.

So, what would a 'build back better world' look like from an environmental sustainability perspective?

Tackling the challenges arising from climate change, biodiversity loss, unsustainable resource extraction and pollution requires a fundamentally different form of economy. At the heart of today's economy is the drive to maximize GDP growth. Capitalism is inherently market-expanding: the incentives are to increase consumption wherever demand can be created, even at the expense of human or planetary health. Consumption means jobs, wealth creation and development; but as wealth and population increase on a finite planet, even increasingly efficient extraction of materials and manufacture of products lead to the use of resources beyond their sustainable availability. Currently humanity is extracting over 100 billion tonnes of material a year from the planet,[35] and the figure is rising fast. Some 75 per cent of this is driven by the activities of high-income economies, which use significantly more than their fair share of global resources.[36] As France's president, Emmanuel Macron, recently said, 'we are living the end of what could have seemed an era of abundance … the end of the abundance of products of technologies that seemed always available … the end of the abundance of land and materials including water'.[37]

'Building back' a better world does not mean deconstructing capitalism, but rather ensuring markets are structured to deliver outcomes that enhance human health and well-being and planetary health.

Reducing absolute demand, in order to live within planetary boundaries, requires both a different mindset and different policy and regulatory incentives. Moving from a wasteful, extractive, linear economy to a more 'circular' one (reducing demand; reusing, repairing and recycling) is a first step. However, for some aspects of the economy, lowering aggregate demand (rather than replacing it with more efficiently produced consumption) should be a primary aim. This is particularly the case when it comes to food, global demand for which is a major driver of climate change, pollution and biodiversity loss. The global production from agriculture far exceeds the supply required for a healthy life, and overconsumption of calories is now the major driver of poor public health globally.

'Building back' a better world does not mean deconstructing capitalism, but rather ensuring markets are structured to deliver outcomes that enhance human health and well-being and planetary health. At the moment, many governments see their role as removing barriers to market operation and economic growth.

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35 Circle Economy (2022), *The Cirularity Gap Report 2022*, https://drive.google.com/file/d/1NMAUtZcoSLwmHt_r5TLWwB28QJDghi6Q/view.
36 Hickel, J. et al. (2022), 'National responsibility for ecological breakdown: a fair-shares assessment of resource use, 1970–2017', *The Lancet Planetary Health* 6.4 (2022): e342-e349.
37 Willsher, K. (2022), 'Macron warns of 'end of abundance' as France faces difficult winter', *Guardian*, 24 August 2022, https://www.theguardian.com/world/2022/aug/24/macron-warns-of-end-of-abundance-as-france-faces-difficult-winter.

Instead, they need to ensure that incentives – taxes, subsidies, regulations – result in markets that deliver economic growth that is positive for people and the planet, rather than profits alone. It means ensuring that the costs of goods and services are not externalized as costs to people's health and the environment. It also means moving from profit maximization as the main rationale behind economic management (i.e. building an efficient but fragile economy) to an approach that looks beyond concepts such as GDP into what could be termed a 'well-being economy' operating within social and planetary boundaries.[38]

In summary, a 'build back better world' requires more than marginal changes to current economies. Unless humanity acts ambitiously and uses the opportunities for significant transformation, currently unsustainable economies will deliver more and bigger crises. One day, the system is likely to break in the face of environmental threats. We have the knowledge to act in advance of this happening, and make the world a better, more equal, less conflicted place.

38 Raworth, K. (2017), *Doughnut Economics*, London: Random House, p. 373.

03
The geopolitics of development

Great power competition is permeating the international development sector to an increasing degree, creating challenges for aid-receiving countries which must navigate shifting geopolitical currents. How can recipient countries establish more equal and effective partnerships with donors?

Cynthia Liao
and Bernice Lee

Despite attempts by the international community to come together through global goal-setting since the establishment of the Millennium Development Goals in 2000 and the Sustainable Development Goals (SDGs) in 2015, a common definition of development remains elusive. Few dispute the imperative of eliminating poverty and meeting basic needs, yet the very concept of 'development' remains politically contentious. Historically, foreign aid and official development assistance (ODA) have helped countries in the developing world respond to crises and address longer-term economic needs. However, aid and development strategies, in their implementation, often intentionally or unintentionally promote unequal donor–recipient dynamics. At times, they encourage what some critics deem paternalistic or even 'neocolonial' relationships. Within donor countries, resistance from populists who consider foreign aid to be a drain on the public finances deters many well-intentioned advocates of ODA. All of this signals a need to re-examine the role of development policies, partners and partnerships to meet the current moment.

What we see today is a confluence of trends that are reshaping the political landscape for ODA and related investments in developing economies. First, China's rise and an intensification of geopolitical competition have heralded the emergence of an ideological, values-based contest over future development models. Second, the COVID-19 pandemic and the associated public debt crisis have heightened the need for rapid, resource-efficient investments. Third, there is an increasing realization that resource-intensive development models may have run their course, given negative effects that include significant climate change. Fourth, the durability of globalization – and the trade and investment dynamics it implies – can no longer be considered a foregone conclusion. Escalating geopolitical tension risks degenerating into a diplomatic 'picking of sides', challenging the model of open markets and free movement that has underpinned trade and investment relationships in recent decades. Developing nations, already in economic difficulty due to the pandemic and other forces, will face increasing political pressure from domestic and international constituencies as they seek to construct the critical partnerships needed to further their development needs.

All of these factors mean that the era in which development is openly acknowledged as a lever for furthering geopolitical aims has fully arrived. The contest to win diplomatic allies and influence ODA partners, in addition to relying on ideology and appeals to values, will very much be about expediency, hard cash and market access. It will also involve development partners – both donors and recipients of aid – jostling to secure long-term economic cooperation and mutual political support. The critical question at this juncture is whether this competition for influence will escalate into something more sinister, foreclosing political options for countries that receive development assistance, or whether it will have a more positive effect in maximizing their long-term strategic manoeuvrability. Either way, the exercise of soft power will increasingly resemble harder power plays.

In this more geopolitically charged climate, the perspectives of recipients get insufficient attention. What are the priorities of such countries? How can and should they navigate the new context to further their own development objectives? Equally, what do donors need to understand better? In this chapter, we will explore these questions first by examining how competing development offerings differ. We will consider the perspectives and priorities of recipient countries, using evidence collected from interviews and research on country responses to current global dynamics. Putting the two sides together, we will present questions for recipient countries to consider in cultivating relations with donors. Lastly, we will suggest guiding principles for managing development relationships in the new geopolitical landscape.

Competition between development offerings – how different are they?

Since the emergence of the COVID-19 pandemic, donor countries have paid renewed attention to the design, effectiveness and affordability of their development assistance strategies. There has been a push to reconsider the merits of existing models and come up with potential alternatives – or, at a minimum, to explore how current approaches might be modified to better meet recipients' actual development needs while acknowledging the new political constraints. This section compares the approach of China, an emerging and increasingly assertive player, with that of established donors in the West.

For China, the onset of COVID-19 slowed progress on existing Belt and Road Initiative (BRI) projects and delayed new project announcements.[39] The pandemic and related economic challenges also prompted China to forgive debts owed by 17 least developed African countries, a move that reflected the problems many countries have faced in meeting BRI-related repayments.[40] China has yet to indicate that it intends to scale back its BRI vision overall, despite the pause in new projects. Nonetheless, there are signs that the Chinese development assistance model is changing. In 2021, China launched its new Global Development Initiative (GDI), ostensibly designed to complement the BRI by providing a mechanism for realizing progress on the SDGs. The GDI departs from the BRI's focus on physical transport and trade infrastructure to include priorities such as poverty reduction, food security, green development and digital connectivity.[41]

There are signs that the Chinese development assistance model is changing. In 2021, China launched its new Global Development Initiative, ostensibly designed to complement the Belt and Road Initiative by providing a mechanism for realizing progress on the SDGs.

China is also perhaps learning from its experience with the BRI and quietly retreating from some of the negative aspects of its approach to date – including concerns around the debt sustainability and environmental footprint of BRI projects. Such concerns have been the source of much scrutiny and criticism of China in recent times.

The GDI also represents a contrast with the bilateral approach typical of China's BRI engagements to date. In a 2022 report by a research institute affiliated with China's State Council, and in subsequent remarks at the United Nations General Assembly, Chinese officials presented a vision that emphasizes achieving the SDGs through cooperation using multilateral institutions and existing mechanisms, but also with Chinese characteristics such as a 'development-first principle' and 'action-oriented' approach.

In the West, many G7 countries have upgraded their own development offerings to respond to global challenges and compete with China. Among the new initiatives are the US-led G7 Partnership for Global Infrastructure and Investment (PGII) and the EU's Global Gateway. While the two initiatives share many priority areas (i.e. climate change, COVID-19 recovery, digital infrastructure, healthcare, gender equality), the US offering emphasizes 'soft infrastructure' while the EU's focuses

39 Mouritz, F. (2020), 'Implications of the COVID-19 Pandemic on China's Belt and Road Initiative', *Connections*, 19(2), pp. 115–24, https://www.jstor.org/stable/26937614.
40 Olander, E. (2022), 'China Cancels Nearly Two Dozen Interest-Free Loans to 17 African Countries', China Global South Project, 22 August 2022, https://chinaglobalsouth.com/2022/08/22/china-cancels-nearly-two-dozen-interest-free-loans-to-17-african-countries.
41 Center for International Knowledge on Development (2022), *Global Development Report*, https://www.fmprc.gov.cn/mfa_eng/topics_665678/2030kcxfzyc/202206/P020220620444256180663.pdf.

more on physical infrastructure within the transport sector.[42] In terms of geography, the PGII covers Eastern Europe, Africa, Asia and Latin America, whereas the EU appears to prioritize its 'near neighbours', including potential partners in Eastern Europe and Africa.[43]

The financial targets are ambitious. The G7 summit in Germany in June 2022 saw a promise to mobilize $600 billion over five years.[44] Previously, the EU had also promised to mobilize €300 billion over seven years. Delivering on these financial commitments will hinge, among other factors, on the ability of G7 governments to secure investments from financial institutions, private enterprises and development finance institutions at multiples of up to 100 times the public budget funding.[45] Thus, one concern for recipient countries is whether the required scaling up of investments will truly happen given the challenging economic outlook.

Similarities and convergence

Despite their supposed differences, the Chinese and G7 development strategies are similar in many ways. They share priorities that include food security, climate change, COVID-19 recovery and digital infrastructure. Both emphasize green and sustainable growth, and engagement through equitable partnerships. The BRI has mobilized a vast network of state-owned enterprises, development finance institutions and private enterprises to supplement Chinese government funding. The G7's approach partly mirrors that of the BRI – by relying on recruiting private sector partnerships and funding to achieve ambitious objectives. Meanwhile, the multilateral and aid-based approach of China's new GDI appears quite similar to UN and Western-style aid programmes in key respects.

Differences in ideology

The main difference between the Chinese and G7 offerings is ideological. Ultimately, each offers a fundamentally competing vision of development assistance.

China has positioned itself as the partner which can best understand recipient-country needs because China itself is a member of the developing world. China appears to seek to influence how international institutions such as the United Nations are

42 The White House (2022), 'Memorandum on the Partnership for Global Infrastructure and Investment', 26 June 2022, https://www.whitehouse.gov/briefing-room/presidential-actions/2022/06/26/memorandum-on-the-partnership-for-global-infrastructure-and-investment.
43 European Commission (2021), 'Questions and Answers on Global Gateway', 1 December 2021, https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_6434.
44 The White House (2022), 'FACT SHEET: President Biden and G7 Leaders Formally Launch the Partnership for Global Infrastructure and Investment', 26 June 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/06/26/fact-sheet-president-biden-and-g7-leaders-formally-launch-the-partnership-for-global-infrastructure-and-investment.
45 USAID (2022), 'USAID Launches Digital Invest Program to Mobilize Private Capital for Digital Finance and Internet Service Providers in Developing Markets as Part of President Biden's Global Infrastructure Initiative', press release, 27 April 2022, https://www.usaid.gov/news-information/press-releases/apr-27-2022-usaid-launches-digital-invest-program-mobilize-private-capital.

structured and governed. It promises a 'true multilateralism' that would elevate the priorities of developing countries in international institutions, and ensure that developing countries are no longer the 'silent majority'.[46]

China's approach to engagement also clearly differs from that of the West by disparaging economic sanctions and interventionism. With African partners, for instance, China conspicuously seeks to distance itself from the West's track record by claiming to oppose interference in African countries' domestic affairs, and to promote respect for sovereignty. It also promises to 'solve African problems the African way'.[47] China has called for more international cooperation on development, has expressed openness to tri-party agreements on tackling development challenges, and has claimed that it seeks to move beyond geopolitical rivalry in the development sphere. The above-mentioned 'development-first principle' in China's new GDI is particularly salient in the climate change debate: China has expressed support for the idea that developing countries should achieve a certain level of development before being pressured to decarbonize, and that in the meantime developed countries should bear most of the burden of delivering (and funding) the transition to a low-carbon or net zero economy. Meanwhile, the G7 ethos of development focuses on good governance, equal partnerships, transparency and democratic values, while promising to deliver high-quality projects and infrastructure.

Neither the Chinese nor Western objectives are problematic at face value – for example, it is axiomatic that development that respects a recipient country's sovereignty should be desirable, just as high standards of governance are indisputably beneficial for ensuring that ODA or similar funding is well managed. However, the key question for recipient countries is how much their alignment with one or other development ideology is likely to cost in a wider sense, for example in terms of diplomatic obligations and loss of geopolitical room for manoeuvre. What mechanisms do donors employ to achieve values-related goals, and what are the potential downsides of such mechanisms?

Looking first at the Chinese approach to development assistance, the challenges for recipient-country diplomacy are abundant. While China's professed respect for sovereignty and the principle of non-interference is welcome for many countries, the reality is that Chinese BRI loans have fuelled corruption, threatening project sustainability and propping up poor governance systems. In addition, China's engagement with recipient states rarely involves local communities or civil society, whose agendas often differ widely from those of their political leaders. With the advent of the GDI, this dynamic may evolve, since projects undertaken through multilateral partnerships will likely need to conform to more stringent standards around inclusivity, fair distribution of benefits, and respect for local needs and sensitivities.

46 Ministry of Foreign Affairs of the People's Republic of China (2022), 'Making Every Effort for Peace and Development and Shouldering the Responsibility for Solidarity and Progress', statement by H.E. Wang Yi, State Councilor and Foreign Minister of the People's Republic of China at the General Debate of the 77th Session of the United Nations General Assembly, 24 September 2022, https://www.fmprc.gov.cn/mfa_eng/wjb_663304/wjbz_663308/2461_663310/202209/t20220925_10771160.html.
47 Ministry of Foreign Affairs of the People's Republic of China (2022), 'China and Africa: Strengthening Friendship, Solidarity and Cooperation for a New Era of Common Development', remarks by H.E. Wang Yi, State Councilor and Foreign Minister at the Coordinators' Meeting on the Implementation of the Follow-up Actions of the Eight Ministerial Conference of the Forum on China-Africa Cooperation, 18 August 2022, https://www.fmprc.gov.cn/mfa_eng/wjb_663304/wjbz_663308/2461_663310/202208/t20220819_10745617.html.

In their relations with the G7, recipient countries will need to reassure themselves that the promised economic benefits of development projects can be delivered in practice, and that conditionality around governance and democracy will not be used to exert undue diplomatic pressure. While G7 members may be able to hold partners in rich democracies to a set of agreed values, in their dealings with the developing world they may have limited mechanisms for enforcing the same standards without edging into what could be interpreted as neocolonialism (ironically, a similar criticism has been levelled at China's BRI-related diplomacy). Will potential recipient countries that fail certain ideological tests no longer be eligible for Western aid and investment? Recipient countries should consider whether they are willing to accept the imposition of Western-driven 'democratic values' in exchange for development assistance, and whether future projects may be at risk should recipient-country actions not conform to such standards.

This matters because, if recent diplomatic and trade actions are a harbinger of what is to come, it is highly likely that the US and other Western partners will continue to use development tools as levers of hard power. The same applies to the coercive use of aid in combination with trade. In a series of meetings across Africa and Asia in August 2022, senior US diplomats offered aid packages while making barely veiled threats of sanctions against any countries that might continue to trade with Russia[48] or maintain close economic or military ties with China.[49] In 2022, the Biden administration delisted three African countries from the African Growth and Opportunity Act (AGOA) – which supports economic development by allowing duty-free exports to the US – because of human rights and democracy concerns. The US decision further demonstrates that sanctions on development-related trade are part of the portfolio of levers that the US is prepared to wield in response to matters which countries would normally consider their internal affairs.[50]

It remains too early to tell how these ideological differences will play out in developing countries and within the broader international system, or how donor efforts to promote values-based development will translate into action in the context of messy realities on the ground. Recipient countries will play important roles in determining how concepts articulated (or implied) in speeches, proposals and funding pledges, and so on, are ultimately realized. However, given the increasing range of development assistance now available to them, recipient countries are arguably better positioned to pick and choose donors whose priorities align with their own, and to negotiate favourable project terms and ensure optimal project design.

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48 United States Mission to the United Nations (2022), 'Remarks by Ambassador Thomas-Greenfield at a Press Conference Announcing $20 Million in Development Assistance in Uganda Amid a Global Food Crisis', 4 August 2022, https://usun.usmission.gov/remarks-by-ambassador-thomas-greenfield-at-a-press-conference-announcing-20-million-in-development-assistance-in-uganda-amid-a-global-food-crisis.
49 Voice of America (2022), 'Blinken Urges Transparency From Cambodia on China-Funded Naval Base', 5 August 2022, https://www.voanews.com/a/blinken-urges-transparency-from-cambodia-on-china-funded-naval-base-/6689109.html.
50 Ogunjuyigbe, O. (2022), 'What does the US decision to delist three African countries from AGOA status imply?', AGOA.info, 11 January 2022, https://agoa.info/news/article/15946-what-does-the-u-s-decision-to-delist-three-african-countries-from-agoa-status-imply.html.

What do recipient countries want, and what must donor countries understand?

Each recipient country's context and development challenges are unique. This section is not an attempt to capture all individual requirements that need to be addressed in establishing equitable and effective donor–recipient relationships. Rather, as countries face many common challenges, this section collates the principal themes that emerge from our analysis of recipient-country assistance priorities. The analysis is based on interviews with members of government, think-tanks and civil society in recipient countries, as well as on public statements.

First, 'business as usual' offerings will no longer be sufficient to meet development needs in the current economic and geopolitical context. In the face of arguably unprecedented challenges, development initiatives must respond to the urgency of action and scale of investment needed to deliver workable solutions on the ground. Assistance packages must address recipient countries' immediate needs as well as their long-term development objectives, and solutions must respond to a multitude of challenges – development, security, climate, economic – at once.

'Business as usual' offerings will no longer be sufficient to meet development needs in the current economic and geopolitical context.

The geopolitical competition between the West and China has prompted each side to publicize the perceived shortcomings of the other's development approach. Developing countries have been reminded even more acutely of the limitations of existing practices, and of the sometimes exploitative nature of relationships structured mainly for the benefit of donor countries, foreign companies and/or local political elites.

From conversations with recipient-country policymakers, we find that developing countries have established their own plans and visions for development, which they seek to emphasize ahead of those of donors and other funding partners. This increases the pressure on donors to offer partnerships that prioritize local development in recipient countries, rather than visibly serving donor-specific economic or geopolitical ambitions. Among potential recipient countries there is plenty of suspicion of, and little appetite for, arrangements that could be seen as embodying 'economic colonialism'. If the accusations directed at the BRI are any indication,[51] donors can expect critical scrutiny of where the profits and benefits from proposed investments are likely to flow; equally, they can expect any damaging evidence to be highlighted and instrumentalized by their geopolitical competitors.

51 Kleven, A. (2019), 'Belt and Road: colonialism with Chinese characteristics', The Interpreter, Lowy Institute, 6 May 2019, https://www.lowyinstitute.org/the-interpreter/belt-and-road-colonialism-chinese-characteristics.

Policymakers and members of civil society in recipient countries also continue to have concerns about issues of justice when considering development pathways. This reflects a long history of overseas investment being misdirected, resulting in underdevelopment: for example, there has often been insufficient investment in industrialization or the development of regional trade, and too much investment in unsustainable natural resource exploitation. Climate and decarbonization constitute another contentious area where issues of justice abound: there remains considerable opposition to the prioritization by donors in some rich countries of renewable energy and the transition away from fossil fuels. Despite its fundamental importance to sustainability, the energy transition is challenging for many recipient countries, as the potentially higher upfront capital expenditure involved can sometimes be perceived as conflicting with energy access and energy security imperatives (the dilemma between investing further in fossil fuels to meet immediate energy and development needs and being asked to make a long-term transition to renewables, for instance, is exacerbated by the perception that poor countries are effectively being expected to bear the costs of rich countries' historical emissions). Donor countries must be sensitive to these issues of justice, and be willing to listen to and respect the needs of recipient-country partners.

Fiscal considerations are also becoming increasingly prominent. Budget constraints associated with the current global economic situation, and with the extraordinary pressures of the COVID-19 pandemic, have left many countries struggling with debt servicing even where creditors have extended repayment periods.[52] Political leaders are being forced to take fiscally contractive approaches, exacerbating underlying development challenges. As a consequence, aid recipient countries are likely to desire development solutions that expand their access to liquidity and offer fiscal flexibility.

Clearly, solutions rooted in national and local contexts are imperative, not least to ensure sustainable implementation and to avoid repeating the failures of aid programmes – however well intentioned – in the past. Both the West and China must be willing to adapt to, and learn from, the circumstances of the countries with which they hope to partner, and must ensure that programming incorporates context-sensitive transfers of skills, expertise and technology in order to create a functional 'ecosystem' of development rather than entrenching patron–client relationships of dependency.

Learning from past mistakes also implies a willingness on the part of donors and investors to engage actively with civil society, communities and the local private sector. Failure to do so has notably been a weakness in China's approach in the past. While China has typically focused its engagement in recipient countries at the level of national political leadership, and has aligned its offerings with national development plans and in consultation with heads of state, it has rarely sought broader buy-in from civil society and local communities; this echoes China's own top-down approach to domestic development. Civil society, local government and local communities must all be engaged to ensure appropriate attention

52 Chabert, G., Cerisola, M. and Hakura, D. (2022), 'Restructuring Debt Of Poorer Nations Requires More Efficient Coordination', IMFBlog, 7 April 2022, https://blogs.imf.org/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination.

to the environmental, social and governance (ESG) dimensions of projects. This offers a substantial opportunity to empower local organizations. On any project, measures of accountability should include the criteria of local stakeholders.

It cannot be overemphasized that recipient countries do not want to be pressured into ‘choosing sides’ between great powers, nor do they relish being told what they can or cannot do.[53] When the US secretary of state, Antony Blinken, visited South Africa in August 2022, he promised that the US would not dictate the choices of African countries. Yet this posture is contradicted in practice by the US’s Countering Malign Russian Activities in Africa Act, which pressures countries that remain neutral over Russia’s invasion of Ukraine. In his September visit to Washington DC, President Cyril Ramaphosa of South Africa expressed his concerns about the legislation. He warned of the ‘unintended consequences of punishing the continent for efforts to advance development and growth’,[54] and urged US lawmakers not to ‘punish those who hold independent views when President Biden has sought to engage African countries on the basis of respect for their independence and sovereignty’.[55] To win the battle for influence, development partners will need to assert their agendas more subtly, and tailor proposals to the development and humanitarian needs of recipient countries. Respecting recipient-country agency will help donor governments win support in the long run. Though some donor countries have developed this sensitivity, the US’s methods still appear to miss the mark – and could appear tone-deaf in the current context. If the US hopes to bring more countries into the sphere of those amenable to its promotion of democracy, good governance and respect for human rights, it will need to approach the subject in a less confrontational or moralizing manner, and with a long-term horizon. Acknowledgment of its own failings on such issues is also critical before it ‘preaches’ values to other countries.

It cannot be overemphasized that recipient countries do not want to be pressured into ‘choosing sides’ between great powers, nor do they relish being told what they can or cannot do.

While the G7 plays up the benefits of strong governance and democratic values, there remains a fine line between insisting on accountability and provoking accusations of interference or undue conditionality. Equally, while recipient countries appreciate China’s professed respect for their ‘sovereignty’, both sides in any development partnership will need to reflect on what the concept of sovereignty means in practice.

53 Research interviews.
54 South African Government (2022), ‘President Cyril Ramaphosa concludes positive Washington DC visit’, press release, 18 September 2022, https://www.gov.za/speeches/president-cyril%C2%A0-ramaphosa-concludes-positive-washington-dc-visit-18-sep-2022-0000.
55 Sahara Reporters (2022), ‘Don’t Tell Us Who To Associate With – South African President Tells US Not To ‘Punish’ Continent Over Russia Relationship’, 17 September 2022, https://saharareporters.com/2022/09/17/dont-tell-us-who-associate-south-african-president-tells-us-not-punish-continent-over.

Questions to consider when evaluating development offerings

In the evolving competition for foreign policy influence through international aid, there are opportunities for recipient countries to tap into external resources that are potentially catalytic for their development. But they must also astutely navigate the geopolitical challenges around such opportunities, to ensure that their priorities are not ignored and to avoid unwittingly becoming the instruments of great power competition. And of course, they must take these necessary precautions without – as far as is possible – delaying important immediate action on economic stabilization and development.

In light of these dilemmas, we offer a checklist of questions for recipient countries to consider when evaluating prospective partnerships and strategic pathways in the contemporary development environment. The checklist is divided into two categories: geopolitical considerations and project considerations:

Geopolitical considerations:

- What are the geopolitical ambitions of the donor, and what kind of political conditions may be attached to this project?
- What are the recipient's diplomatic priorities, and how could aligning with the external partner support these priorities or threaten their accomplishment?
- What other partners and institutions can strengthen the recipient country's negotiating position or leverage?
- Is there a potential 'third way'? Are there options to combine resources from competing partners in a collaborative project?

Project considerations:

- How does the offering align with domestic and regional priorities?
- Who benefits most from the project, and who bears the costs?
- Does the proposal meet international standards in terms of quality, environmental impact, social impact and monitoring?
- What were the favourable and unfavourable outcomes of other projects involving this partner (bearing in mind the experiences of other recipient countries)?

With these questions in mind, recipient countries can carefully consider the medium- and long-term impacts of development partnerships, and learn from one another's experiences to negotiate favourable and equitable terms for their projects.

Conclusion: A new approach for a new era of development

Development is inescapably being affected by escalating geopolitical competition, but it remains unclear whether the consequences will be positive or negative. How recipient countries adapt to changes in the development landscape will be a major factor in determining whether aid relationships are ultimately equitable and effective rather than exploitative.

Will development in recipient countries benefit from increased attention and resource mobilization, even if the ultimate intention behind donor engagement is to advance geopolitical interests? Or will recipient countries be caught in the middle of great power competition, with their priorities compromised or distorted and projects held hostage to donor agendas?

What is clear is that recipient countries must proactively develop coherent responses to shifting geopolitical dynamics, and must not overlook this moment as an opportunity to elevate their development agendas and priorities. Recipient countries must engage with clear-eyed awareness and consider all the relevant risks and opportunities.

A new era of development requires a new approach. In crafting such an approach, recipient countries have various tools and levers at their disposal. Using these, countries can learn from past mistakes, push development partners to improve their offerings and practices, and more effectively 'build back better' despite geopolitical uncertainty. Below we outline a few guiding principles for developing-country governments considering aid or development partnerships:

- Recipient countries should engage with all willing development partners and aim to **preserve their right to partner** with any country, regardless of its political alliances, and not accept development assistance that closes off other options or relationships. This will help countries to resist political pressure from a single partner.

- Recipient countries should **use transparency as a tool** for securing their interests. Maintaining transparency about the involvement and interests of domestic and international stakeholders, regional alliances and donor-country commitments can encourage partners to strengthen their development offers and practices. Public scrutiny also makes it difficult for partners to hide malign intent.

- Recipient countries should **recognize and fully exploit their negotiating power**. Being a pawn in a geopolitical game brings challenges, but recipient countries can also turn the situation to their advantage by being aware of the criticality of their cooperation in the wider geopolitical ambitions of their prospective partners. Strategically keeping their options open can allow recipient countries to insist on specific requirements or contractual provisions, on the understanding that they can walk away or choose other donors should the terms be inequitable. No longer should unequal donor–recipient dynamics prevail – recipient countries have something (their cooperation) which donors want, and should use this to their full advantage in negotiations.

- Recipient countries **must not lose sight of their own development needs and agendas**. Prospective partners will likely offer other incentives in seeking to influence investment priorities, but recipient countries must be the main guardians of their own development trajectories.
- Recipient countries should **anticipate risks, build resilience and avoid dependency**. Their leaders need to be fully aware that any development offers and trade deals negotiated today may be vulnerable to future events, such as changes in economic, political or geopolitical conditions. Recipient countries need to be prepared for such contingencies: designing resilience into local economies and industries, avoiding patterns of overreliance on any one partner or programme, and working with allies to limit any unwanted leverage that external partners may seek to apply. While considering these factors adds complexity to long-term development planning, it is also useful thinking that will help prevent the dependency that has been a feature of some aid relationships in the past.

As the geopolitical dimension of development takes on a more confrontational nature, there is perhaps room for cautious optimism that developing countries can find a path forward in this new landscape – one that could allow their development needs and priorities to be better addressed. The intensification of geopolitical competition comes at a time when many developing countries now realize the flaws in, and negative consequences of, the donor approaches of Western governments/agencies and Chinese entities respectively. Recognition of the shortcomings of established development assistance models – notwithstanding their many benefits as well – can incentivize recipient countries to both raise their own standards and demand more of their partners. Perhaps within this competition lies an opportunity for recipient countries to push donors to learn from each others' mistakes and upgrade their approaches.

04
The role of the G20 in mobilizing private development finance

G20-led efforts to recruit private capital to finance international development have in the main disappointed. Any new initiative must leverage private sector expertise more effectively, reflect the common interests of G20 members and respect the agency of beneficiary countries.

Theo Beal
and Creon Butler

Context

Since its inception as a finance ministers' group in September 1999, the G20 has grappled with the challenge of how to achieve high and sustained financial flows, both public and private, to emerging economies and low-income developing countries in order to underpin growth and human development.

The epicentre of the global financial crisis in 2008–09 lay in the advanced economies, but the establishment of a leader-level version of the G20 combined with the experience of successful cooperation in response to that crisis gave the group's accompanying efforts to enhance development finance a strong boost.

In particular, the overarching instrument shaping the G20's efforts after the crisis, the Framework for Strong, Sustainable and Balanced Growth launched by G20 leaders at the 2009 Pittsburgh summit, was in large part intended to provide precisely the policy environment required to stimulate high and sustained financial flows to the developing world.

The framework itself has not delivered on its early promise,[56] but G20 summits since Pittsburgh have included a number of complementary initiatives designed to leverage international cooperation to strengthen investment flows to the developing world. These have typically drawn on the core features of the G20 process: leader-level endorsement of commitments; a consensus-based, 'country-led' approach to policy formulation; reliance on the leading international financial institutions (IFIs)[57] for technical support and delivery; and outreach to and engagement with other stakeholders, including non-member countries and the private sector.

The post-Pittsburgh initiatives have also reflected the founding context of the G20. Thus, in the early years after 2009, nearly all leading G20 members acknowledged the importance of private finance in international development. They also acknowledged that international cooperation was vital to address many global threats to prosperity, and that – once the immediate financial crisis had abated – it was important to use the new system to continue tackling the underlying causes of financial instability and prevent future economic crises.

This chapter looks in detail at two specific but related cases in which G20 presidencies have sought to use new initiatives, introduced at G20 summits, to boost investment flows to the developing world. The first is the Compact with Africa (CWA), launched by the German G20 presidency in 2017, and designed to boost private investment in Africa. The second is the Global Infrastructure Project Pipeline, one of the outputs of the Global Infrastructure Hub (GI Hub), established under the Australian G20 presidency in 2014, and designed to improve the micro-level bankability of infrastructure projects.

Both initiatives were led by effective and well-resourced G20 presidencies. They were central to those presidencies' summit deliverables, and both also specifically envisaged enhanced cooperation between the official and private sectors. While the Australian presidency took place against the backdrop of Russia's 2014 annexation of Crimea and territorial aggression in eastern Ukraine, and the German presidency in 2017 had to work around US president Donald Trump's rejection of many key principles of multilateralism, the level of trust and willingness to cooperate among G20 members was nonetheless substantially higher than it is today.

After briefly describing the two cases and considering what worked and what did not work, this chapter will seek to apply the resulting lessons to the present-day situation facing the G20. We will offer recommendations on how the G20 may yet

56 Butler, C. (2012), 'The G-20 framework for strong, sustainable, and balanced growth: glass half empty or half full?', *Oxford Review of Economic Policy,* 28(3), pp. 469–92.
57 We define the term IFIs to include the IMF, World Bank Group and established multilateral development banks, i.e. international economic organizations that are *primarily* financial and have features of banks – raising money and lending it.

be used as a vehicle to drive progress in international development and related policy areas. We do not argue for wholesale reform of the G20, essentially because we do not see this as a realistic option in the present circumstances. Instead, our aim is to suggest how the existing institution can best be deployed to unlock greater private development finance.

G20 initiatives: two case studies

A. Compact with Africa: an investor-friendly, 'de-risked' environment

In 2017 the Compact with Africa (CWA) was launched under the auspices of the German G20 presidency with a mission 'to increase attractiveness of private investment through substantial improvements of the macro, business and financing frameworks'.[58] The CWA represented a thematic continuation of the work of previous G20 presidencies. This activity included the first Multi-Year Action Plan on development, announced in Seoul in 2010, which prioritized public–private partnerships and efforts to enhance domestic investment climates for infrastructure in low-income countries.[59] It also included the creation of a study group, unveiled in Moscow under Russia's G20 presidency in 2013, to explore 'obstacles and limitations delaying long-term financing'.[60]

The creation of the CWA took place against the backdrop of growing Western concern over China's bilateral economic and political influence in the developing world, particularly in Africa, underpinned by extensive lending under the Belt and Road Initiative (BRI). The CWA also served as a launchpad for Chancellor Angela Merkel's bilateral focus in German–African diplomacy on business and investment. This was embodied by the Pro! Africa initiative, which sought to increase the participation of German firms in African economic development.[61]

The CWA was inherently high-level in its design, and featured multiple amorphous policy streams. It aimed to improve macroeconomic conditions, reform business environments, boost intermediation in the financial sector,[62] and thus drive a significant increase in private investment in Africa. Risk mitigation (or 'de-risking') was central to the CWA's strategy of establishing risk–return profiles attractive to investors. Instruments to achieve this, outlined at the creation of the CWA, focused on promoting blended finance through increased collaboration between development institutions, public finance institutions and private funds. Specific proposed tools included the provision of guarantees for

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58 G20 Compact with Africa (2022), 'About the Compact with Africa', https://www.compactwithafrica.org/content/compactwithafrica/home.html.
59 OECD (2010), *G20 Seoul Summit 2010: Multi-Year Action Plan on Development,* https://www.oecd.org/g20/summits/seoul/Annex2-Multi-Year-Action-Plan-Development.pdf.
60 Kappel, R., Pfeiffer, B. and Reisen, H. (2017), *Compact with Africa: fostering private long-term investment in Africa*, Discussion Paper, No. 13/2017, https://www.econstor.eu/bitstream/10419/199503/1/die-dp-2017-13.pdf.
61 German Federal Ministry for Economic Affairs and Energy (2017), *Pro! Africa: Promoting the prospects, taking the opportunities, strengthening the economies,* https://www.bmwk.de/Redaktion/EN/Downloads/strategiepapier-pro-afrika.pdf?__blob=publicationFile&v=6.
62 Ladipo, O. (2018), 'Compact with Africa: Linking policy reforms with private investment', World Bank Blogs, 11 September 2018, https://blogs.worldbank.org/nasikiliza/compact-with-africa-linking-policy-reforms-with-private-investment.

infrastructure and debt projects, and the use of credit tranching and bundling to appeal to more risk-averse investors.[63] A key feature of the CWA was the enhancement of country-level cooperation – both among IFIs, and between IFIs and recipient governments – to increase the coherence of IFI advice and lower transaction costs.

Five years on, it is apparent that the CWA's de-risking instruments have not delivered the wide-scale mobilization of private finance that was hoped for. The most recent CWA Monitoring Report in May 2022 stressed the need for development partners across the G20 to provide further de-risking instruments, and found that 'reforms (or the promise of reforms) may not be sufficient to attract private investors which are often faced with the risks and costs of being first movers'.[64]

There is unease around the possibility of recipient governments burdening themselves with unreasonable risk to incentivize private sector investment.

A clear challenge inherent in the CWA's approach to risk mitigation is its heavy and consistent reliance on public institutional capital from multilateral development banks (MDBs) and development finance institutions (DFIs). This is understandable given the political influence of MDBs within challenging development contexts – influence which private sector banks lack.[65] One potential solution would be for G20 members themselves to allow more efficient use of existing MDB capital[66] and/or to provide more capital to MDBs, which could make it easier for the latter to increase their own offers.[67] However, this approach could prove hard to deliver given geopolitical shifts towards bilateralism – including, notably, among long-standing champions of multilateral approaches, as seen with the UK's commitment to reduce foreign aid funding to multilateral institutions.

Other criticisms of the CWA take specific issue with the de-risking approach, citing 'moral hazards' in the compact's perceived subsidization of unsuitable or excessively risky projects.[68] There is also unease around the possibility of recipient

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63 African Development Bank, IMF and World Bank Group (2017), *The G-20 Compact with Africa: A Joint AfDB, IMF and WBG Report,* p. 29, https://www.compactwithafrica.org/content/dam/Compact%20with%20Africa/2017-03-30-g20-compact-with-africa-report.pdf.
64 World Bank Group (2022), *CwA May 2022 Monitoring Report: Africa Advisory Group Meeting May 16, 2022,* p. 38, https://www.imfconnect.org/content/dam/Compact%20with%20Africa/reports/CWA%20Monitoring%20Report%20-%20May%202022.pdf.
65 McHugh, C. A. (2021), 'Mobilising Private Funding of Development Finance', *The Journal of Development Studies,* 57:12, 1979-2001, doi: 10.1080/00220388.2021.1945042.
66 See Italian and Indonesian Presidencies of the G20 (2022), *Boosting MDBs' investing capacity: An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks*, July 2022, https://g20.org/wp-content/uploads/2022/07/CAF-Review-Report.pdf.
67 Indeed, the latest G7 industry-led taskforce has suggested a shared burden, i.e. that the onus should not just be on MDBs or DFIs to increasingly mobilize the private sector, and that they should in turn be provided with additional finance by G7 shareholders. Impact Taskforce (2022), *Time to deliver: mobilising private capital at scale for people and planet,* https://www.impact-taskforce.com/media/gq5j445w/time-to-deliver-final.pdf.
68 Lay, J. (2017), 'The G20 Compact with Africa: An Incomplete Initiative', GIGA Focus Africa, No. 2, June 2017, German Institute of Global and Area Studies (Leibniz-Institut für Globale und Regionale Studien), https://pure.giga-hamburg.de/ws/files/21669426/web_africa_2_2017.pdf.

governments burdening themselves with unreasonable risk to incentivize private sector investment.[69] In reference to infrastructure financing in particular, the European Network on Debt and Development (Eurodad) argues that de-risking through the standardization of projects threatens infrastructure quality, reduces public oversight and compromises compliance with environmental standards.[70]

Notwithstanding such misgivings, there is also evidence of successes in some CWA partner countries, such as Ghana. Supported by the African Development Bank (AfDB), a system has been established to 'de-risk agricultural lending from financial institutions', while reforms to company registration in Ghana have made it easier to set up businesses.[71]

The remit of the CWA also brings certain fundamental challenges. Its sheer breadth, despite operating in just 12 partner countries, has unavoidably delayed delivery and led to a level of policy paralysis. This has been compounded by the disparate nature of measures introduced under the programme, and by its involvement of a multitude of state and non-state actors. In 2019, the CWA was judged by one initial advocate to have evolved into a 'bureaucracy-driven proliferation of support measures'[72] that led to general inaction without sufficient understanding of its benefits from private or institutional investors. Ironically, bureaucracy is one of the very constraints on private sector investment which the CWA seeks to address, and was identified as a key concern by participants at the Africa Investment Forum in 2019.[73]

Finally, the CWA has been criticized for failing to emphasize African agency in its approach. A consistent tension remains between the priorities of private investors recruited into CWA mechanisms and meaningful development of the target countries themselves. The reality is that both sides need to co-exist. As Paul Collier, an academic at Oxford University, asserts: 'Changes happen not by reluctant governments being coerced, but as successful pioneers get emulated.'[74]

B. Global Infrastructure Project Pipeline: improved 'bankability' and micro-level interventions

Improvement of the macro environment and effective de-risking are only part of the battle against a scarcity of 'bankable' projects on the ground – i.e. those that are viable and attractive for private investors. The issue has become acute

69 Brookings Institution (2017), 'G-20 Compact with Africa: Supporting the SDGs and Agenda 2063', https://www.brookings.edu/events/g-20-compact-with-africa-supporting-the-sdgs-and-agenda-2063.
70 Romero, M. J., Sonkin, F. and Sial, F. (2021), 'The relentless quest to mobilise private investment in infrastructure: more de-risking is not the answer', Eurodad, 18 June 2021, https://www.eurodad.org/the_relentless_quest_to_mobilise_private_investment_in_infrastructure.
71 Seidu, D. (2020), *G20 compact with Africa: The case of Ghana*, Policy Briefing 191, South African Institute of International Affairs, p. 7, https://saiia.org.za/wp-content/uploads/2020/01/Policy-Briefing-191-Seidu.pdf.
72 Kappel, R. and Reisen, H. (2019), *G20 Compact with Africa: The Audacity of Hope*, Berlin: Friedrich-Ebert-Stiftung, https://library.fes.de/pdf-files/iez/15748.pdf.
73 Compact with Africa (2019), 'Leveraging the G20 Compact with Africa for Increased Investment: The Private Sector Perspective', meeting summary, https://www.compactwithafrica.org/content/dam/Compact%20with%20Africa/events/AIFNov2019/AIF%202019_Session%20notes%20CWA%20meeting.pdf.
74 Collier, P. (2018), 'Foresight Africa viewpoint – The G-20 Compact with Africa: African-driven programs', Brookings Institution, 6 February 2018, https://www.brookings.edu/blog/africa-in-focus/2018/02/06/foresight-africa-viewpoint-the-g-20-compact-with-africa-african-driven-programs.

as sustainable finance gathers momentum. Growing the pipeline of bankable projects in infrastructure can be done through non-regulatory micro-level interventions such as improved information sharing and early-project approaches.

Effective sharing of information on project pipelines can ensure that a diverse range of investors accesses opportunities in emerging economies. The G20 has focused on developing tools for such coordination in relation to infrastructure investment. In 2016, the G20's Global Infrastructure Hub (GI Hub) introduced the Global Infrastructure Project Pipeline,[75] a 'one-stop shop' that integrates national and multilateral databases of investment opportunities. However, the creation of the Global Infrastructure Project Pipeline does not necessarily reduce the significant procedural burden on the investor or funding recipient. Confusingly, a variety of other institutions established or endorsed by the G20 have similar functions to that of the GI Hub, and in some cases partner with one another.[76] These include the Global Infrastructure Connectivity Alliance (GICA), the Global Infrastructure Facility (GIF) and the Multilateral Cooperation Center for Development Finance (MCDF).[77] Given the significant complexity this presents in terms of project visibility and the potential duplication of project opportunities in multiple databases, it is understandable that donors continue to streamline their engagement across fewer bodies, and that they consolidate resources and project pipelines where possible to 'drive scale and competition in opportunities for private finance'.[78]

Advancements in early-stage project preparation and related approaches will increase the scalability of projects, improve take-up from private investors and reduce the burden on public institutional capital.

Another method for ensuring the bankability of projects is to improve their quality and reduce the cost of design and preparation phases. (This brings additional benefits, by reducing the corruption risks associated with the artificial inflation of project costs.)[79] In 2016, several MDBs launched SOURCE: a global initiative, in response to the G20, to provide assistance in project preparation, boost the crowding-in of private finance, and increase the number of bankable infrastructure projects. However, SOURCE relies on limited public institutional capital to achieve these quality goals, and it has insufficient engagement with

75 Timbs, R. (2017), 'The Global Infrastructure Project Pipeline: Linking private investors with public infrastructure projects', World Bank Blogs, 16 February 2017, https://blogs.worldbank.org/ppps/global-infrastructure-project-pipeline-linking-private-investors-public-infrastructure-projects.
76 Global Infrastructure Hub (2017), 'GI Hub and Global Infrastructure Connectivity Alliance sign MoU', news release, 8 May 2017, https://www.gihub.org/news/gi-hub-and-global-infrastructure-connectivity-alliance-sign-mou.
77 Nedopil, C., Larsen, M. L., Yue, M. and Wang, Y. (2021), 'Prospects of the Multilateral Cooperation Center for Development Finance (MCDF) to catalyse infrastructure financing', *Asia & The Pacific Policy Studies*, 9(1), pp. 81–110, https://onlinelibrary.wiley.com/doi/pdf/10.1002/app5.345.
78 Glasgow Financial Alliance for Net Zero (2022), *The Potential for Country Platforms to Mobilize Capital for Net-Zero Transition in Emerging Markets and Developing Economies: Private Sector Statement,* draft, https://assets.bbhub.io/company/sites/63/2022/07/GFANZ-Country-Platform-Private-Sector-Statement-July-2022.pdf.
79 Sustainable Infrastructure Foundation (SIF) (2022), 'Source: the Multilateral Platform for Sustainable Infrastructure', https://public.sif-source.org/source.

private sector expertise to improve the suitability of infrastructure projects. Equally, a 2020 study found that the G20 needs to reform its policy and institutional frameworks, as these 'rarely leverage private sector expertise to improve project development'.[80] The integration of the private sector into the improvement of project development will also help with misaligned risk expectations in sustainable finance.[81] The Asian Development Bank's Asia Pacific Project Preparation Facility (AP3F)[82] shows promise: this $73 million multi-donor trust fund aims to improve early-stage projects, for example by soliciting technical input from private sector experts.

Advancements in early-stage project preparation and related approaches will increase the scalability of projects, improve take-up from private investors and reduce the burden on public institutional capital. This would help deliver on part of the 'billions to trillions' ambition laid out by MDBs in 2015, when they endeavoured to catalyse support for project preparation to 'shorten timelines, ensure project structures are appealing to investors and financiers active in the sector, and help address regulatory and policy environment issues important to potential investors'.[83]

Lessons for future G20 initiatives

For analysts and scholars in the area, the fact that annual G20 summits repeatedly propose greater recourse to private sector capital has elements of 'groundhog day'. Earlier initiatives from the 2010s overlap significantly with recent proposals – also of limited impact – from summits in the 2020s. The G7 London Impact Taskforce has warned that 'today's glaring gap between rhetoric and delivery not only feeds public skepticism, it also prompts existing risks to grow in size and severity'.[84]

Notwithstanding these persistent doubts over political will and commitment to implementation, a number of lessons for future G20 initiatives in this area may be drawn from the two cases discussed above:

— First, **keep things simple**. Devising bureaucratic mechanisms to deliver complex goals drawing on contributions from varied actors is a key role of the G20, but it is critical that any new mechanism be straightforward to use. This means pushing back against one of the disadvantages of the 'country-led' approach: the tendency for each G20 member to advance its own policy perspective or regional interest in any given initiative.

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80 Ava, P. et al. (2020), *Building the Future of Quality Infrastructure*, Asian Development Bank Institute, https://think-asia.org/bitstream/handle/11540/11576/adbi-building-future-quality-infrastructure.pdf?sequence=1#page=46.
81 AVPN (2022), *AVPN Input Paper for the G20 Sustainable Finance Working Group*, https://g20sfwg.org/wp-content/uploads/2022/07/Results-of-a-consultation-to-understand-the-non-regulatory-barriers-in-efforts-to-develop-and-scale-sustainable-finance-instruments-across-Emerging-Markets-and-Developing-Economies-in-Asia-AVPN-%E2%80%93-ACN.pdf.
82 Asian Development Bank (2016), 'Asia Pacific Project Preparation Facility (AP3F)', https://www.adb.org/sites/default/files/publication/183639/ap3f-flyer.pdf.
83 World Bank and IMF (2015), 'From Billions to Trillions: Transforming Development Finance', 2 April 2015, p. 14, https://thedocs.worldbank.org/en/doc/622841485963735448-0270022017/original/DC20150002EFinancingforDevelopment.pdf.
84 Impact Taskforce (2022), *Time to deliver*, p. 8.

— Second, **avoid overreach**. The two case studies demonstrate that communicating a strong need and clear vision is critical for any initiative to gain traction. But it is also important to start with an objective that is plausibly within reach of the available political commitment, resources and bureaucratic capabilities – even though some element of 'stretch' is desirable. Setting a goal, however well justified, that has no chance of delivery is likely to be counterproductive. On the other hand, success in one initiative can quickly build the trust, commitment and capabilities to take on bigger goals.

— Third, **listen to those you are trying to help**. A key strength of the G20 (compared with both the G7 and BRIC groupings) is the greater legitimacy its broad-based membership and economic weight bring to its actions. But when the beneficiaries of G20 policies are non-members, as is the case with the CWA, it is essential to listen to what the beneficiaries themselves want and build in genuine participation and agency from the outset. One must also avoid a one-size-fits-all approach. Any G20 initiative designed to work at country level needs to be developed with sufficient flexibility to be adapted to local circumstances and, where appropriate, integrated with national development plans.

— Fourth, **rethink the G20's method for engaging with the private sector**.[85] While each G20 presidency is responsible for devising its own means for soliciting the views of the private sector, there is now a fairly settled approach under which a formal 'B20' advisory group is established. This group is typically led by one of the host country's leading business executives, and often also involves business federations from other G20 members. The B20 typically comes up with a free-standing set of recommendations that are formally presented ahead of that year's G20 summit. Much effort goes into making these recommendations succinct and practical, but there remains a high risk that neither the B20's outputs nor the agendas of its participants will align with the priorities of the presidency or of leading member states. A G20 presidency may also undertake extensive bilateral consultation with domestic businesses that have expertise on a particular initiative that the presidency is pursuing. However, in these cases there is typically a strong desire on the part of the presidency and/or leading G20 members to avoid the appearance of giving disproportionate weight to one or more businesses in the design of proposed initiatives. Otherwise this can lead to the suspicion that the initiative has been designed only to serve a narrow interest group. Finding a way to engage with the international private sector on G20 initiatives in a way that recognizes these sensitivities is therefore a priority if more effective use is to be made of public–private partnerships both in the investment arena and more widely. To get this right a presidency may have to invest quite a bit of time and effort, but the results could well pay off. Key elements should include: defining and agreeing with other G20 members at the outset specific questions for the private sector group to answer; consulting other member countries on the selection of participants but not following the route whereby each country gets to choose its own representative; and insisting on participants having widely recognized expertise in the focus area and independent standing.

85 This recommendation draws on Ava et al. (2020), *Building the Future of Quality Infrastructure*.

Next steps?

In addition to the lessons from past initiatives, it is important to take account of the **changed political circumstances** in which the G20 is operating today. There is a contrast between the spirit of cooperation that prevailed in the years shortly after the 2008–09 global financial crisis and the more confrontational atmosphere that exists today. A range of contemporary or recent developments have lowered trust among the G20. These include the legacy of the Trump administration's rejection of multilateral approaches to addressing global problems; Russia's full-scale invasion of Ukraine in early 2022, and the subsequent disagreement between the West and other G20 members over whether Russia should be suspended from the G20; and US–China tensions over Taiwan.

It is important to focus G20 initiatives on areas in which a genuine common interest can be found. Fortunately, mobilizing development finance is one of these.

In these circumstances, more than ever, it is important to focus G20 initiatives on areas in which a genuine common interest can be found. Fortunately, mobilizing development finance is one of these. And whereas the G20 initiatives on private finance discussed in this paper have to some degree been in the 'nice to have' category, the critical need to finance the transition to a carbon 'net zero' economy over a very short space of time now makes this an emergency on a scale comparable to, or even greater than, the global financial crisis.

A further challenge is that views have changed over the past decade on the **role of the private sector** in providing global public goods. China, for one, is working to reduce the power and influence of its domestic private sector, while the COVID-19 pandemic has illustrated the importance of governments giving the private sector clear direction in times of crisis. On the other hand, Western leaders, at least, remain clear on the critical importance of private sector finance.[86] In addition, the movement on corporate adherence to environmental, social and governance (ESG) values, and the debate over 'profit with purpose', demonstrate a greater recognition among many international business leaders of the need to go beyond simply 'complying with all relevant domestic laws' of the countries in which they operate. This diversity of views on the inherent utility of private sector engagement makes it challenging to design G20 initiatives focused on stimulating and enhancing private finance.

86 At COP26 the US treasury secretary, Janet Yellen, said: 'Private capital is essential to our success. As we work to mobilize this capital, we must continue to focus on addressing the challenges that emerging markets and developing countries face in attracting private sector financing.' US Department of the Treasury (2021), 'Delivering Finance for Emerging Markets and Developing Economies: Speech, Janet L. Yellen, Secretary of the Treasury, Glasgow, Scotland', 3 November 2021, https://home.treasury.gov/news/press-releases/jy0465.

With this context in mind, a priority for the G20 should be to establish a new initiative to support the mobilization of private finance for development. Such an initiative **must work at both a technical and political level**, and be clearly seen to do so, on the grounds that success will make more ambitious proposals possible. And while the focus should continue to be on addressing the core challenges of the business environment and the bankability of investment projects in recipient countries, it will be important – particularly in the present political context – for the presidency to take enough time to fully consult other G20 members and stakeholders. This is a task for the Indian G20 presidency in 2022/23.

Preparatory work at the start of the Indian G20 presidency should focus on the following questions:

- Where does the G20 consensus *now* lie on the role of the private sector and public institutional capital in development finance? How far does this align with the latest research findings, and how have things changed – compared with previous G20 initiatives – as a result of the climate emergency? Given this, what practical steps can be taken and gaps filled through G20 action?
- What initiatives in particular can be developed to enhance private development finance which do *not* rely on increased public institutional capital? While a capital increase or more flexibility in capital use for the IFIs may be agreed in the coming months, this is very unlikely to be on a scale that addresses the fundamental constraints on investment flows.
- How should a new initiative to generate additional private finance – whether for green infrastructure or other policy priorities – deal with the fact that many potential recipients in low-income countries already have too much debt?
- What generic factors apply across all regions and can be incorporated in a G20 initiative? In so far as there are critical variations across regions, how can these variations be built into the initiative?
- What mechanisms need to be put in place from the outset of the presidency to ensure more effective and genuine consultation with recipient countries and the private sector?

Armed with the outputs of this work, the new G20 initiative should seek to break with typical previous practice by explicitly building on and reinforcing – rather than duplicating or overlapping with – pre-existing G20 initiatives in the same policy space. This will do much to ensure such an initiative is effective and long-lasting.

05 Conditionality in the global financial architecture

Conventional models of foreign aid and macroeconomic support, in which creditors typically demand policy reforms in return for providing financing, are widely criticized as outdated and inequitable. 'Conditionality' will remain relevant, but the system must become more cooperative, locally focused and pragmatic.

Rebecca Christie

Introduction

Financial crisis has shaped international financial architecture throughout the modern era, from the 1944 Bretton Woods conference to the 2009 G20 summit and on to the present day. The world's leading economies have sought global institutions to support financial stability, preserve access to markets, and encourage not only prosperity but convergence between countries at different levels of development. Each of these goals supports the others: as developing economies catch up with their more developed peers, in theory a more stable world economy should emerge and systemic threats should be reduced.

This synergy only works if all stakeholders follow through on their commitments. Too often prospective development projects and stability initiatives are stymied by onerous 'conditionality' (in the policy jargon), exacerbated by some combination of micromanagement from creditors and inadequate compliance on the part of funding recipients. A better approach would be to set more modest but achievable parameters from the outset, encouraging local political 'ownership' of agreed policy conditions and thus creating the best chances of success. Conditionality only succeeds if the conditions are right.

There is no shortage of need. The G7 countries have estimated that funding for infrastructure in developing regions is more than $40 trillion short of what is required.[87] In July 2022 the Bridgetown Initiative, a high-level forum co-hosted by UN Deputy Secretary-General Amina Mohammed, called on the World Bank and regional development banks to increase lending by $1 trillion per year by 2025 and to mobilize $3 trillion per year in private capital as well.[88] Macroeconomic stability also continues to require global action, as loss of market access can be devastating to countries at all levels of development. Current global economic pressures, including high inflation and rising concerns about debt sustainability in the developing world, increase the need for international organizations that can offer financial support.

Providing that support has fallen traditionally to the International Monetary Fund (IMF) and the World Bank, which formed the post-war vanguard of global economic cooperation under the Bretton Woods agreements. They have been joined by regional institutions such as the European Stability Mechanism and the Asian Infrastructure Investment Bank (AIIB), among many other donors and lenders. While all these institutions typically offer loans and economic oversight, their missions vary considerably: some focus on monetary stability and financial surveillance; others on how to channel public investment to, and encourage development in, countries where the private sector is unwilling or unable to act alone. But almost all such institutions bring conditions and monitoring along with outside funding.

Too often, conditionality is associated with downsides that range from operational inefficiency to political interference, especially when conditions are poorly designed and excessively applied.

At best, these requirements introduce useful guiding frameworks and safeguards to ensure recipient countries make the most of the money disbursed. Too often, however, conditionality is associated with downsides that range from operational inefficiency to political interference, especially when conditions are poorly designed and excessively applied. The overall effect, in recipient countries, can be more one of reducing political ownership of economic reform and development than of preventing moral hazard. The enduring challenge is how to streamline

87 The White House (2021), 'FACT SHEET: President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership', press release, 12 June 2021, https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/12/fact-sheet-president-biden-and-g7-leaders-launch-build-back-better-world-b3w-partnership.
88 The Bridgetown Initiative (2022), 'High-Level Retreat on a Global Financial Architecture for a World facing Global Shocks', 30 July 2022.

and improve conditionality to increase the chances that funding will be used effectively, without abandoning the core principles of transparency and accountability demanded by investors, donors and creditors.

The need for reform

The IMF and World Bank have not done a good enough job of preventing economic and financial crises around the world,[89] or of following through on internal structural reforms to democratize their own governance[90] and render themselves more responsive to, and reflective of, the contemporary global economic order. In turn, evolving recipient-country needs and widespread dissatisfaction with the Bretton Woods architecture have increased demand for alternative sources of financing, contributing to an increasingly crowded field of more than 40 development banks and international financial institutions. The implications of this trend are uncertain. On the one hand, the growing number of players offers opportunity for swifter and more agile responses to new developments and crises. On the other, overlapping membership and growing bureaucracy suggest inefficiency and wasted resources may be inevitable.

IMF conditions have long been criticized as unworkable, despite their theoretical appeal as a means of optimizing programme performance. While it might seem as if spelling out detailed policy goals should lead to success, history tells a different story. As Axel Dreher, an academic, wrote in 2009 after an extensive survey of research on IMF conditionality: 'There is no empirical evidence showing that conditions enhance ownership or make program success more likely.'[91] Dreher further argues that the IMF should not be involved in development aid, and that its market access programmes would do better if countries were subject to *ex ante* conditions – mandates to strengthen their economic resilience during normal times – as opposed to facing procyclical *ex post* requirements during and immediately after a crisis period. Instead of eliminating moral hazard as intended, conditionality has prevented full distribution of funding and has made it harder to complete projects. A detailed programme that will never be carried out as planned is unlikely to lead to good outcomes.

Conditionality debates are not purely a one-way conversation in which richer countries – or international organizations dominated by them – dictate policy to the developing world. Sometimes conditionality debates happen even within the developed world. The EU, for example, has been both an aid provider and an aid recipient in recent years. Its policymakers continue to argue that aid money – for disbursement both within the EU and outside it – should come with strings attached, while ignoring lessons from past crises in terms of which conditions

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89 Dreher, A. and Gassebner, M. (2012), 'Do IMF and World Bank Programs Induce Government Crises? An Empirical Analysis', *International Organization*, Volume 66, Issue 2, pp. 329–58, https://www.cambridge.org/core/journals/international-organization/article/abs/do-imf-and-world-bank-programs-induce-government-crises-an-empirical-analysis/CB95CBAB7E7E28693F04376D0DCC5177.
90 Woods, N. (2003), 'Unelected Government: Making the IMF and the World Bank More Accountable', Brookings Institution, 1 March 2003, https://www.brookings.edu/articles/unelected-government-making-the-imf-and-the-world-bank-more-accountable.
91 Dreher, A. (2009), 'IMF conditionality: theory and evidence', *Public Choice* (2009) 141: pp. 233–67, doi: 10.1007/s11127-009-9486-z.

are most likely to work. This mistake hurts the effectiveness of new and ongoing programmes, while also making development relationships more combative than collaborative. Mutual accountability is essential.

Lessons from China, Africa and the EU

To see how conditionality fits in with development and economic assistance goals, it is useful to review the shifting landscape of aid providers and the politics of how such aid is provided. If detailed conditions worked as well as their supporters claimed, one would expect their use to be fairly consistent across the board. Instead, evidence finds that the presence of conditions is linked more to the politics of *who is lending or donating*, rather than the likely project outcome.

The global order of today brings into play a wide range of stakeholders and strategic considerations that potentially shape funder–recipient relationships. China, in particular, stands out for its emergence as an increasingly active provider of development aid – even as it remains a recipient of unsubsidized World Bank development loans itself.[92]

China's presence in this sector is arguably rendering conditionality, at least in the traditional sense understood by the 'Washington consensus', less central. A 2017 study found that for 54 African countries receiving assistance between 1980 and 2013, every percentage point increase in Chinese aid resulted in 15 per cent fewer World Bank conditions, with lesser effects observed during part of that time for aid from Kuwait and the United Arab Emirates.[93] Yet aid from the developed world, as represented in the OECD's Development Assistance Committee, is associated with increased requirements. This suggests that some official creditors may be piling on conditions in part for political reasons, rather than wholly based on economic fundamentals, given that China's emergence as an alternate source of funds seems to be enough to lead to a noticeable drop in strings attached.

China stands out for its emergence as an increasingly active provider of development aid – even as it remains a recipient of unsubsidized World Bank development loans itself.

The EU's experience during its internal debt crisis in the 2010s is instructive in this respect. The evidence shows that policy conditions, and the accompanying stigma that came with their enforcement, repeatedly undercut efforts to restore financial

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92 Huang, Y. (2020), 'Why Is the World Bank Still Lending to China?', Carnegie Endowment for International Peace, 15 January 2020, https://carnegieendowment.org/2020/01/15/why-is-world-bank-still-lending-to-china-pub-80830.
93 Hernandez, D. (2017), 'Are "New" Donors Challenging World Bank Conditionality?', *World Development*, Volume 96, August 2017, pp. 529–49, https://www.sciencedirect.com/science/article/abs/pii/S0305750X17301055.

stability. An academic study by Wade Jacoby and Jonathan Hopkin indicates that conditionality took on outsized political influence during the euro crisis, while having only a marginal effect on outcomes.[94]

In playing up the perception of moral hazard if aid-receiving euro members were granted more economic policy autonomy, European policymakers appear to have been unaware of the poor track record of conditionality around the world. Instead, they were swayed by the one-off success of earlier conditions imposed on candidate countries during the process of accession to the EU itself. Policymakers also appear not to have realized that conditionality in relation to EU enlargement may have succeeded in the first instance because the reform milestones for accession to the EU were so concrete, in contrast with the vaguer and broader goals of the macroeconomic assistance programmes. As Jacoby and Hopkin put it, 'happy economic outcomes are not the EU's to bestow'.[95]

In hindsight, Europe moved too conservatively to help Greece when the country first lost its ability to borrow in public markets in early 2010, resulting in financial contagion across the euro area. The inadequacy of Greece's first bailout, followed by overly aggressive pursuit of the many conditions attached to a second rescue package, forced the country to seek an unprecedented third round of economic aid in 2015 as political tensions pushed the euro area to the brink of fragmentation. The debate haunts the euro area still, and investors have not recovered full confidence in the monetary union, where every attempt to strengthen the euro's basic architecture is laden with moralistic debates about preventing aid from flowing to the 'undeserving'.

The irony is that at times of risk, the EU's detailed budget conditions have frequently and successfully been suspended. For example, the EU's annual budget process has regularly been set aside when enforcement of its longer-term goals has clashed with more urgent economic needs. As a result, countries such as Italy,[96] France[97] and even Germany[98] have avoided censure when in breach of EU fiscal rules. Policy during the COVID-19 pandemic also provided an exception to strict enforcement of the normal protocols. As Mia Mottley, the prime minister of Barbados, said in September 2022, there is a perception in the developing world that 'the countries which bear the responsibility for the real problems in global financial services, appear to be exempt from rules and scrutiny to which developing countries are subjected'.[99]

94 Jacoby, W. and Hopkin, J. (2019), 'From Lever to Club? Conditionality in the European Union During the Financial Crisis', paper accepted for publication in the *Journal of European Public Policy*, 17 November 2019, http://eprints.lse.ac.uk/102563/1/From_Lever_to_Club_JEPP_Re_Submission_Final_Version_.pdf.
95 Ibid.
96 Valero, J. (2019), 'Italy escapes EU budget sanction procedure after spending cuts', EURACTIV, 4 July 2019, https://www.euractiv.com/section/economy-jobs/news/italy-escapes-eu-budget-sanction-procedure-after-spending-cuts.
97 Spiegel, P. (2104), 'France narrowly avoids EU fine for ineffective action on deficit targets', *Australian Financial Review*, 1 December 2014, https://www.afr.com/policy/economy/france-narrowly-avoids-eu-fine-for-ineffective-action-on-deficit-targets-20141201-11x9hk.
98 Deutsche Welle (2006), 'Minister Says Germany Off the Hook in EU Budget Deficit Affair', 9 September 2006, https://www.dw.com/en/minister-says-germany-off-the-hook-in-eu-budget-deficit-affair/a-2168895.
99 Kofi Annan Foundation (2022), 'The Inaugural Kofi Annan Lecture delivered by Hon. Mia Amor Mottley', 23 September 2022, https://www.kofiannanfoundation.org/vision-annan/kofi-annan-lecture-2022-mia-mottley.

Calls now to restore full compliance with the EU's fiscal rules have at times seemed more driven by ideology than practicality. Yet despite the global and Europe-specific evidence that conditions do not work very well and are not always aligned with participants' strategic interests, countries such as Germany with a history of supporting fiscal discipline are once again renewing calls for recipients of assistance to accept greater macroeconomic and fiscal discipline, ostensibly as a means of risk mitigation.

A changing global landscape, and new coordination challenges

The Bretton Woods system itself has been responding to a changing world order. The World Bank has continually revisited its own conditionality framework and attempted to adjust to evolving external circumstances. A quantitative text analysis of the bank's contracts shows that its loan conditions have changed substantially over time – this finding contrasts with outside criticisms that the bank is prone to institutional inertia and susceptible to political influence.[100] The study finds that requirements appear to change based on bank policy, rather than in response to country-specific developments, and are applied in fairly uniform fashion. This suggests that the World Bank is doing a good job of coordinating its internal policies but could do more to adapt its lending to local conditions and expertise.

With the world economy slowing in 2023, emerging markets may have renewed trouble repaying their existing obligations, especially when borrowing in currencies that are not their own. The G20 group of major economies (an economic forum that includes China) and the Paris Club of creditors (which does not) agreed in 2020 on a Debt Service Suspension Initiative,[101] followed by a common framework for debt restructuring for the lowest-income countries that are part of these efforts.[102] Yet these international programmes do not address the quandary of bilateral development loans from China, which is now the largest creditor to some emerging market countries. Such loans are opaque and full of 'hidden' default events.[103] Finding ways to restructure these obligations may prove as central to boosting development as finding funding for new projects.

There is also the issue of ensuring the international coherence of assistance relationships, to avoid unwarranted overlap between agendas. The G7 has pledged to improve cooperation on global development finance while managing 'strategic competition' with China,[104] as Beijing is tackling similar infrastructure needs

100 Cormier, B. and Manger, M. (2020), 'The Evolution of World Bank Conditionality: A Quantitative Text Analysis', as presented at the 2020 PEIO conference, https://www.peio.me/wp-content/uploads/2020/01/PEIO13_paper_46.pdf.
101 Paris Club (2022), 'The Paris Club has fully and successfully implemented the DSSI and its extensions', press release, 23 February 2022, https://clubdeparis.org/en/communications/press-release/the-paris-club-has-fully-and-successfully-implemented-the-dssi-and-its.
102 G20 and Paris Club (undated), 'Common Framework for Debt Treatments beyond the DSSI', https://clubdeparis.org/sites/default/files/annex_common_framework_for_debt_treatments_beyond_the_dssi.pdf.
103 Horn, S., Reinhart, C. and Trebesch, C. (2022), *Hidden Defaults*, Kiel Working Paper 2208, Kiel Institute for the World Economy, January 2022, https://www.ifw-kiel.de/fileadmin/Dateiverwaltung/IfW-Publications/-ifw/Kiel_Working_Paper/2022/KWP_2208_Hidden_Defaults/KWP_2208.pdf.
104 The White House (2021), 'FACT SHEET: President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership'.

via the Belt and Road Initiative (BRI), launched in 2013. China is now working with more than 70 countries in Africa, Europe and Asia on infrastructure and other development projects, and is widely considered to be using the BRI as a mechanism to provide strategic direction as well as financial support. It remains to be seen whether Chinese and other global efforts will work in parallel, in competition or at cross purposes, particularly given the more crowded landscape of international financial institutions.

A more multipolar global economy offers the chance to rebalance the power dynamic between the creditor-country old guard and the developing world. Ngaire Woods, an academic, makes the case that emerging markets are changing the rules of the game without a rush to lower standards and weaken policies.[105] Instead, the presence of newer actors has exposed weaknesses in the old system, and reinforced the argument that donors are most successful when they work collaboratively with other actors.

The debate over the new AIIB, headquartered in Beijing, has added to the salience of these questions. More than 100 countries, including many in Europe, have joined the AIIB since it opened in 2016, but the US and Japan have remained outside its framework and have tried – unsuccessfully – to discourage other Western countries from participating. Some commentators have suggested that the US should drop its reluctance and sign on to the AIIB,[106] but the US continues to keep apart due to a combination of political concern and economic self-interest. To the extent that development aid is a strategic lever as well as an instrument of economic growth and climate investment, these competing considerations limit each other.

Most recently, the conflict in Ukraine, following Russia's full-scale invasion in early 2022, has caused donors to rethink their strategic and financial priorities. The conflict has exacerbated political fragmentation and cut into development funds available for other uses or recipients. As noted in a June 2022 Chatham House research paper,[107] this has been one of the major factors holding back the G7's 'Build Back Better' partnership in the year after the initiative was put forward (it has subsequently been rebranded, in effect, as the Partnership for Global Infrastructure and Investment). Yet ignoring the needs of lower-income countries will exacerbate the challenges facing the G7 itself, so its members cannot afford to neglect stability and prosperity in the developing world. Donors will need to establish 'genuine and equitable partnerships' with recipients,[108] taking advantage of local knowledge and experience so that the multilateral system can work to best effect.

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105 Woods, N. (2008), 'Whose aid? Whose influence? China, emerging donors and the silent revolution in development assistance', *International Affairs*, 84(6), pp. 1205–21.
106 Lazarus, L. (2016), 'Why the U.S. Should Embrace the AIIB', *The Diplomat*, 2 March 2016, https://thediplomat.com/2016/03/why-the-u-s-should-embrace-the-aiib/; Balachandran, N. (2017), 'The United States Should Join the Asian Infrastructure Investment Bank', *Asia Pacific Bulletin*, Number 397, 20 September 2017, East-West Center, https://www.eastwestcenter.org/publications/the-united-states-should-join-the-asian-infrastructure-investment-bank; and Dove, S. (2022), 'Consider the Counterfactual: Why the US Should Join the AIIB', Australian Institute of International Affairs, 17 February 2022, https://www.internationalaffairs.org.au/australianoutlook/consider-counterfactual-why-us-should-join-aiib.
107 Liao, C. and Beal, T. (2022), *The role of the G7 in mobilizing for a global recovery*, Research Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2022/06/role-g7-mobilizing-global-recovery.
108 Ibid.

A more collaborative model?

Encouraging local ownership of, and responsibility for, development programmes could have the double benefit of improving outcomes and reducing tension over whether Washington or Beijing may be exercising outsized influence on recipient countries. If such countries feel they have more control, their governments are more likely to find the necessary political will to follow through on promises and comply with programme conditionality. Developing countries also should seek, and be offered, more incentives to work in ways that complement the economic interests of the world's richest economies, rather than seeing developed-world considerations such as climate change mitigation as an obstacle to their economic goals.

Global economic recovery in the aftermath of the pandemic will require sustained and effective action to build infrastructure and make the transition to climate-friendly technologies. Ricardo Hausmann, a former Venezuelan planning minister turned Harvard academic, says decarbonization efforts 'will transform global production and trade patterns so radically that new growth opportunities are bound to arise for savvy countries of the Global South'.[109] These countries have an opportunity to carve out a role for themselves and access funding accordingly.

Encouraging local ownership of, and responsibility for, development programmes could have the double benefit of improving outcomes and reducing tension over whether Washington or Beijing may be exercising outsized influence on recipient countries.

To sum up, the Bretton Woods institutions and development banks need an environment of mutual accountability in which to fulfil their missions. This will require their conditions for financing to be fit for purpose. Recipient countries will need to take political responsibility for programme success early on, to help design agendas that advance their own economic development and have realistic targets. Creditor countries and organizations will need to resist the temptation to grandstand in the name of fiscal discipline or combating climate change. In particular, funding providers should resist the urge to invoke moral hazard as a way of justifying parsimony and control. Instead, all stakeholders should cooperate on setting more mundane conditions that can be fully implemented, to give development programmes the best chance of success.

The goal should be a framework that is adaptable, streamlined, and takes account of the ways in which geopolitical and economic power imbalances affect policy. International financial institutions must now adapt to shifts in the global financial system to reconsider which of their conditions remain necessary and which can be set aside.

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109 Hausmann, R. (2021), 'Is Green Development an Oxymoron?', Project Syndicate, 1 June 2021, https://www.project-syndicate.org/commentary/decarbonization-green-technologies-developing-countries-growth-by-ricardo-hausmann-2021-06.

06 Climate finance

'Building back better' has an aspirational climate investment component. For sufficient capital to flow to low- or zero-carbon assets, policymakers must both incentivize the rebalancing of portfolios around climate-friendly instruments and develop a more consistent global reporting framework.

Lilia Caiado Couto

Introduction

Responding effectively to the climate crisis will require a profound reallocation of capital from high-carbon to low- or zero-carbon assets. The operation of the international financial system is critical to this transition. The additional capital spending on physical assets needed to achieve climate policy goals may be equivalent to around 2 per cent of global aggregate GDP between 2026 and 2030.[110] This will only be affordable if investment is transferred from fossil fuel industries.

Ensuring that finance flows to low- or zero-carbon solutions is a highly complex process. Because it will involve coordination between several parts of the financial system, no class of institution can solve the problem independently. Compounding the challenge is the current global economic situation, characterized by surging inflation, slowing or negative GDP growth and rising debt in many markets. This could mean that tackling climate change does not appear an immediate priority for financial policymakers, regulators or investors. Yet the need is urgent, given the severity of existing climate impacts and the likely length of the timescale for the net zero transition (starting already in this decade). In short, the world has only one shot at getting climate finance right, which means it needs to use all the tools available.

A first principle is that mobilizing capital at sufficient scale will rely on leverage of public financial mechanisms to generate much larger private financial flows. Several public instruments are considered effective in this respect. They include

110 McKinsey & Company (2022), *The net-zero transition: What it would cost, what it could bring*, https://www.mckinsey.com/business-functions/sustainability/our-insights/the-net-zero-transition-what-it-would-cost-what-it-could-bring.

risk mitigation instruments such as guarantees and government loans, which can be provided through national development banks (NDBs) with the support of multilateral development banks (MDBs). Secondly, central banks and financial regulators are increasingly recognizing the systemic threat climate change poses to financial stability, and thus the potential role of levers such as climate-related macroprudential regulation and new monetary policy approaches. Additionally, there has been much discussion of the environmental implications of fiscal responses to the COVID-19 pandemic, and by extension the role of national discretionary fiscal stimulus to propel climate action.

Mobilizing capital at sufficient scale will rely on leverage of public financial mechanisms to generate much larger private financial flows.

Emerging markets and developing economies (EMDEs) concentrate most of the world's physical potential for renewable energy generation and nature-based climate solutions. They also tend to be the most vulnerable to the physical impacts of climate change, and thus share strong reasons to seek climate investment. But the capacity of different EMDEs to attract international finance for climate solutions varies. It depends on the enabling environment, and on investor perceptions of risk in each country. EMDEs normally have higher political, regulatory and macroeconomic instability (factors often related to, or exacerbated by, currency devaluation), as well as significant exposure to inflation risk and higher levels of indebtedness.

One of the impediments to progress is the lack of a global framework defining low-carbon investments, without which it is harder for EMDEs to attract the capital they need. (The issue is discussed in more detail in this chapter in the section on 'Global reporting'.) The proposed creation of a 'Climate Club', announced by the German G7 presidency in June 2022,[111] seeks to address this gap by supporting the development of a globally consistent investment taxonomy.

The original idea of a climate club was that participating countries should agree on an international carbon price.[112] Although reaching a common carbon pricing mechanism globally is not feasible, the World Bank and the International Monetary Fund (IMF) have recently focused on incentivizing and supporting countries to reform fossil fuel subsidies and establish a carbon tax, so that the costs arising from greenhouse gas emissions are internalized in investment decisions. However, depending on the inclusivity of such a club's membership, and the stringency of its membership criteria, the establishment of an intergovernmental forum of this nature could create political tensions – particularly with large emerging and emitter markets, notably China and India.

111 G7 Germany (2022), 'G7 Statement on Climate Club', 28 June 2022, https://www.g7germany.de/resource/blob/974430/2057926/2a7cd9f10213a481924492942dd660a1/2022-06-28-g7-climate-club-data.pdf?download=1.
112 Nordhaus, W. (2015), 'Climate Clubs: Overcoming Free-Riding in International Climate Policy', *American Economic Review*, April 2015, 105(4): pp. 1339–70, http://dx.doi.org/10.1257/aer.15000001.

With this context in mind, this chapter explores how different parts of the financial system might interact to assist the world's shift to a net zero investment model, and how such a transformation could be achieved at a moment when multiple economic and other crises confront political leaders and financial policymakers. The chapter outlines the critical nodes of international cooperation needed to raise climate investment opportunities in EMDEs, and assesses potential solutions that include leveraging public finance to generate private sector funding, de-risking investments through multilateral guarantees, and supporting climate action through central banks and financial regulators.

The picture so far

Lessons from COVID-19, fiscal and inflationary pressures, political tensions

Economic challenges associated with the COVID-19 pandemic, Russia's invasion of Ukraine, and ongoing climate impacts have significant implications for the transition to net zero. To date, the evidence on the fiscal feasibility of such a transition is mixed. On the one hand, policy support that governments introduced during the pandemic sent an important signal that rapid, large-scale investment is possible in response to global crises. By inference, COVID-19 action therefore also demonstrated the principle that capital could be reallocated at scale to address *other* threats to human well-being – such as the climate crisis. Since then, the 'build back better' movement has emphasized the need for climate-compatible policy responses,[113] as evidenced for example by the provisions of the US government's Inflation Reduction Act of 2022.[114]

On the other hand, the mobilization of national budgets during and since the pandemic has generated new concerns about fiscal sustainability. This is of particular concern for EMDEs, where expansionary fiscal policies have led to further indebtedness and have triggered capital withdrawal from some markets. Should such pressures go unaddressed, or intensify, it will be harder for many governments to find the financing or political support needed to promote the net zero transition.

A further potential distraction from climate finance reform is the current inflationary picture, affecting advanced and developing economies alike. Western sanctions on Russian exports of oil and gas have contributed to substantial energy price increases, a key component of higher inflation rates in many countries. While the UK is a notable example in the developed world,[115] some of the largest secondary impacts of the Ukraine invasion have occurred in oil-importing developing economies. Many of these, coincidentally, hold great potential for renewable energy deployment and energy efficiency, and include India, Kenya,

113 Rochedo, P. R. R. et al. (2021), 'Is Green Recovery Enough? Analysing the Impacts of Post-COVID-19 Economic Packages', *Energies* 2021, 14(17), 5567, https://doi.org/10.3390/en14175567.
114 US Senate (2022), 'Summary: The Inflation Reduction Act of 2022', https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_one_page_summary.pdf.
115 Office for National Statistics (2022), 'Consumer price inflation, UK: September 2022', 19 October 2022, https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/latest.

Malawi, Pakistan and Uganda. In addition to the situation in Ukraine, climate impacts have contributed to higher energy prices in EMDEs such as China and Brazil, where droughts have hindered hydropower generation.

Meanwhile, political tensions between the world's two largest greenhouse gas emitters, China and the US, continue to threaten the global fight against climate change. The impacts on climate diplomacy are potentially significant, given that the success of the 2015 Paris Agreement will in large part depend on the efforts of these two countries. Climate strategies not only in the US, but globally, are also highly dependent on imports of Chinese renewable energy technology. This creates vulnerabilities for technology-importing countries should their political relations with China deteriorate.

Overall, the headwinds outlined here translate into a risk that governments and financial institutions will not act radically enough to curb climate change, and that they will focus instead on issues such as addressing short-term inflationary pressures at the expense of critical longer-term climate action.

Policy development and climate investment: mixed progress

Notwithstanding the challenges mentioned above, the financial sector has made modest progress towards a net zero transition in recent years. Initiatives have involved both public and private sector players. First, several central banks have announced that they will require financial institutions to comply with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), a body established in 2015 to promote transparency around climate risk exposures in financial markets and to aid the pricing of such risk. Second, the coalitions formed under the UN Race to Zero framework,[116] notably the Glasgow Financial Alliance for Net Zero (GFANZ),[117] seem to have committed enough in assets under management to cover the financing needs of the net zero transition (although it is far from guaranteed that these sums will be translated into actual climate investments).[118] Third, while considerable scepticism surrounds private financial institutions' climate pledges – considered by some to consist of little more than 'greenwashing' – public institutions such as central banks and financial sector supervisory bodies are working to ensure the integrity of those commitments. They are cooperating internationally on the issue, particularly through the Network for Greening the Financial System (NGFS).[119]

Investment in the low-carbon transition has also been galvanized, to a degree, by geopolitical events. Russia's full-scale invasion of Ukraine in early 2022 made it clear that the solution to energy security should be to invest in clean

116 Glasgow Financial Alliance for Net Zero (2021), 'Race to Zero Financing Roadmaps', https://www.gfanzero.com/netzerofinancing.
117 https://www.gfanzero.com.
118 Andrijevic, M. et al. (2020), 'COVID-19 recovery funds dwarf clean energy investment needs', *Science*, Vol 370, Issue 6514, pp. 298–300, https://www.science.org/doi/10.1126/science.abc9697; Vivid Economics (2022), *Race to Zero Financing Roadmaps*, https://www.gfanzero.com/netzerofinancing; Buchner B. et al. (2021), *Global Landscape of Climate Finance 2021,* Climate Policy Initiative, December 2021, https://www.climatepolicyinitiative.org/wp-content/uploads/2021/10/Full-report-Global-Landscape-of-Climate-Finance-2021.pdf.
119 Network of Central Banks and Supervisors for Greening the Financial System (2019), 'Origin and Purpose', 13 September 2019, https://www.ngfs.net/en/about-us/governance/origin-and-purpose.

energy, not to lock economies further into fossil fuel infrastructure. Investments in energy efficiency and clean energy have increased in many countries in response to fuel price inflation, and as a means to reduce exposure to fluctuations in the supply of Russian oil and gas.[120] Less positively, the war in Ukraine has concurrently stimulated investment in fossil fuel exploration, as consumer countries have scrambled to shore up hydrocarbon supplies for existing infrastructure that will not be replaced immediately.[121]

In short, the ultimate impact on emissions of the current energy crisis is still unclear, and is likely to vary from region to region.

Global reporting: the missing link?

As mentioned, a central issue blocking further progress remains the lack of common reporting tools so that investors can determine the net impact of different investment profiles, understand the characteristics of assets compatible with a net zero transition, and seek investment opportunities accordingly. The current patchwork of partial reporting systems seems too large and fragmented – with some practitioners lamenting that financial institutions have to provide an 'alphabet soup' of data to comply with different requirements.

There is an urgent need for uniform standards and metrics so that portfolio alignment with net zero commitments is defined consistently. A clear global taxonomy of net-zero-consistent investments would also help to ensure the integrity of private finance commitments to the climate transition.

This underlines several points. First, a large amount of climate disclosure data continues to be produced in relatively haphazard fashion. Second, the databases concerned have yet to be systematized or made openly available – a prerequisite if the information in them is to become useful for decision-making. Third, there is an urgent need for uniform standards and metrics so that portfolio alignment with net zero commitments is defined consistently. A clear global taxonomy of net-zero-consistent investments would also help to ensure the integrity of private finance commitments to the climate transition – reducing the risk of capital being allocated to assets that may appear compliant on paper but be less sustainable in practice.

120 United Nations Conference on Trade and Development (2022), *World Investment Report 2022: International tax reforms and sustainable investment*, https://unctad.org/webflyer/world-investment-report-2022.
121 Energy Policy Tracker (2021), 'Track public money for energy in recovery packages', updated 31 December 2021, https://www.energypolicytracker.org.

A global framework is also vital for determining whether public investment into the post-COVID-19 economic recovery is consistent with climate goals. Such a framework could help to resolve dilemmas around the choice of investment structures, given the difficulty of assessing the relative merits of (a) purely public investments which can be leveraged to generate complementary private finance in related activities, or (b) more complex jointly funded projects. While the former may be preferable in terms of speed and value for money, the latter may be more effective at raising private capital.

At the same time, climate investment disclosure mechanisms, though clearly useful for financial decision-making, have a potential drawback. By revealing risks and problems more transparently, they can actually make it harder for EMDEs to attract climate finance. Reporting of exposures in countries in which physical climate impacts are the harshest – often EMDEs – can lead to capital withdrawal.

Market perceptions of risk may also reflect the dominance of infrastructure in net-zero-consistent investments. As an asset class, infrastructure is considered high-risk due to its substantial upfront costs and lengthy payback periods. This is particularly the case in countries where governance and institutions are weak, and where domestic capital markets are less developed. Projects promoting adaptation to climate change tend to be particularly complex. Not only do these normally involve large-scale infrastructure, but many have what can be described as an 'agency' issue: that is, because the investments are a public good, the future beneficiaries are to some extent unclear. This can make it challenging to attract finance.

Finally, the public–private interactions central to financing climate-related infrastructure investment carry a risk of systemic corruption. Such risk is increased at times of crisis (as was the case at the height of the COVID-19 pandemic).[122] Emergency public expenditure usually occurs at speed, and thus potentially bypasses sound procurement processes. In the context of the low-carbon transition, this has added relevance because investment in climate change mitigation and adaptation will become increasingly urgent as climate action is delayed.

Leveraging public mechanisms to raise private climate finance

Given the huge sums involved and the fiscal constraints mentioned above, climate investment is only likely to be effective under a global approach that overcomes the current limitations of multilateral policymaking. Depending on the circumstance, several types of institution may need to be recruited to work on the issue, and they will often need to interact with each other. As outlined below, these include national development banks (NDBs), multilateral development banks (MDBs), central banks and financial regulators.

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122 Butler, C., Hagan, S. and Martin, D. (2022), *Climate Change Financing and Corruption Risks*, Washington, DC: Peterson Institute for International Economics (in press).

The role of NDBs and fiscal policy

NDBs can provide public equity capital in combination with private sector debt, thereby ensuring a level of public sector control over investment decisions. Public–private partnerships (PPPs) could provide the instrument of choice for climate-sustainable investments, for example financing long-term concessions in the power sector (including both renewable energy generation assets and transmission/distribution infrastructure). When NDBs co-finance infrastructure projects, they help reduce risk, lower borrowing costs and increase financial leverage.[123]

NDBs, particularly those with domestic fiscal support, are useful when borrowing costs are high and financing conditions difficult, as they can offer lower interest rates than other lenders to the right projects.[124] For example, the terms of NDB lending to projects accredited as net-zero-consistent can be more favourable than the terms available from commercial banks for similar projects. Additionally, NDBs can add grants to the financing mix to lower the interest rates on their loans, particularly when projects are less commercially viable.[125]

Tax breaks and public spending can complement NDBs in stimulating climate investment. An example is the above-mentioned US Inflation Reduction Act of 2022,[126] which targets investment in cheap, clean energy to reduce energy costs. The rationale is that by investing $369 billion in clean energy, the US government will lower household bills by $500–1,000 per year.

MDBs and multilateral guarantees

MDBs can contribute to de-risking – and thus stimulating – climate investment in EMDEs by offering multilateral sovereign guarantees backed by advanced-economy governments. These guarantees protect investors and lenders. As perceptions of climate investment risk in EMDEs increase, the use of such 'multi-sovereign' guarantees can enable developed countries with high credit ratings to join together in backing infrastructure projects in the developing world; this reduces costs and can expand EMDE access to capital markets, particularly for small states that would otherwise struggle to find financing.[127]

The US is a prominent example of an advanced economy which has provided sovereign guarantees on EMDE bond issuance for infrastructure investment. The US has preferred the guarantee mechanism over more onerous forms of traditional aid, because it offers scale, speed and efficiency at a low cost to the guarantor

123 Griffith-Jones, S., Attridge, S. and Gouett, M. (2020), *Securing climate finance through national development banks*, ODI Report, London: Overseas Development Institute, https://www.econstor.eu/handle/10419/216988.
124 Ibid.
125 Ibid.
126 US Senate (2022), 'Summary: The Inflation Reduction Act of 2022', https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_one_page_summary.pdf.
127 Hourcade, J. C. et al. (2021), *Scaling up climate finance in the context of Covid-19: A science-based call for financial decision-makers*, Incheon, South Korea: Green Climate Fund, https://www.greenclimate.fund/sites/default/files/document/scaling-climate-finance-context-covid-19-executive-summary_0.pdf.

country.[128] Arguably, adapting existing sovereign bond guarantee programmes so that they can be used for climate investment in developing economies should be straightforward. This could be effective in de-risking investment in EMDEs, channelling capital to low- or zero-carbon infrastructure and reducing emissions globally.[129]

Establishing multilateral guarantees could also accelerate international cooperation on the much broader topic of climate-related financial reporting and compliance. The process of setting up multi-sovereign guarantees could encourage coordination between investment regimes, as it would oblige governments to collectively define climate assets that are suitable for institutional investors seeking 'safe havens'.[130]

Central banks and financial regulators

Central banks and financial regulators have important roles to play in the net zero transition. They can mandate the use of transition plans by multinational financial institutions; incorporate climate adjustment criteria into monetary policy and financial regulation instruments (for example, through collateral rules and capital adequacy requirements); and manage their own asset purchase programmes and portfolios so that their holdings are more climate-aligned.

Changes to collateral frameworks

The adjustment of collateral frameworks according to the emissions profiles of investments should follow broadly the same selection criteria used for multi-sovereign guarantees. Essentially, this would consist of lowering the market value of an asset used as collateral for a loan (increasing the 'haircut' taken by the borrower, in other words) if that asset exceeds a certain threshold of emissions or climate risk. Equally, central banks could apply the same process in reverse: reducing the haircut associated with environmentally more sustainable assets. They could arguably even go further and determine the eligibility of assets for use as collateral based on the emissions profiles of those assets.

Market signalling: prioritizing purchases of climate-friendly bonds

Central banks' market behaviour, via asset purchases and management of their portfolios and reserves, can boost climate-consistent investment by sending signals to institutional investors. The debate on this area originally developed around the use of 'green' quantitative easing (QE)[131] by central banks in the aftermath of the 2008–09 global financial crisis. Green QE means prioritizing the purchase

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128 Morris, S., Rockafellow, R. and Cameron, A. (2022), *Greening the US Sovereign Bond Guarantee Program: A Proposal to Boost Climate-Directed Sovereign Finance in Developing Countries*, CDG Policy Paper 250, Washington, DC: Center for Global Development, https://www.cgdev.org/publication/greening-us-sovereign-bond-guarantee-program-proposal-boost-climate-directed-sovereign.
129 Ibid.
130 Hourcade et. al (2021), *Scaling up climate finance in the context of Covid-19*.
131 QE consists of central banks buying government or corporate bonds to increase bond prices. This tends to decrease bond yields, or the 'interest rates' that holders of these bonds get. The lower interest rate on bonds then feeds through to lower interest rates on loans across the economy, helping to boost consumer and business spending and keep inflation at its target level. See Bank of England (2022), 'What is quantitative easing?', KnowledgeBank, https://www.bankofengland.co.uk/monetary-policy/quantitative-easing.

of so-called 'green bonds' (a specific category of asset, the proceeds from which are directly committed to climate-related activities), or of other bonds associated with climate-friendly sectors and assets.

By choosing to sell off polluting assets first, thus altering the climate weighting of their portfolios, central banks would send a very strong signal, which market players could emulate by rebalancing their own holdings accordingly.

Especially when markets face headwinds such as the COVID-19 pandemic or the energy crisis associated with the Russian invasion of Ukraine, central banks can perform a crucial service by prioritizing which bonds to purchase, or keep in their portfolios, and which to divest. By choosing to sell off polluting assets first, thus altering the climate weighting of their portfolios, central banks would send a very strong signal, which market players could emulate by rebalancing their own holdings accordingly. If central banks were to exclude carbon-intensive assets from their bond holdings, this would be an important step in going beyond the conventional risk approach to bond portfolio management (which essentially balances three objectives: liquidity, safety and returns). In other words, central banks could manage their portfolios according to climate risk as well as credit risk, and could extend such an approach to several areas of their work – including management of their policy portfolios, the execution of asset purchase programmes, and the pursuit of other monetary policy goals.

Conclusions and next steps

This chapter has argued that the essential first step towards shifting the international financial system to net zero and attracting private finance to climate investment opportunities in EMDEs is to ensure *regulatory consistency*. Central banks and financial regulators should lead the process of determining what net zero alignment means for the financial system, and of setting out specifically which financial products – or characteristics in financial products – investors should look for to weight their portfolios accordingly.

By cooperating through bodies such as the NGFS – but also through non-climate-specific economic forums – central banks and financial regulators should establish high-level principles to inform the design of a single taxonomy of climate investments. This would facilitate efforts to harmonize the patchwork of existing systems and ensure the comparability of metrics and reporting standards. Coordination in this area can also aid the identification of global best practices on net zero portfolio alignment.

Leadership and political will are needed to drive these proposed changes, but it is not yet clear what the most effective and realistic structures should be. Should coordination be led by public institutions, political leaders, or persons or entities within the private sector? A further consideration, partially alluded to above, is that coordination needs to happen beyond the existing – i.e. non-financial – international climate architecture. Climate issues should be integrated into all countries' broader financial, economic and development objectives.

The strongest push for reform may come from the G7. In 2021, the G7 stated that its finance ministers and central bank governors supported 'mandatory climate-related financial disclosures that provide consistent and decision-useful information for market participants and that are based on the TCFD framework'.[132] The G7 could intertwine this proposition with the creation of its aforementioned 'Climate Club'.[133] The two efforts could be coordinated through a dedicated working group, which would establish data production requirements, conduct modelling to generate information for investment decision-making, and create guidance on climate alignment for portfolios across financial institutions of all types.

Once in place for G7 countries, such a system could serve as a template for other countries or groupings to follow. The G20, although facing challenges of unity and cohesion in the context of Russia's invasion of Ukraine, might play a similar – and potentially even more powerful – role along similar lines in the future. This could build on the activities of its working group on sustainable finance.

Box 3. A proposal for a new CFI – a 'climate finance institution'

Mark Malloch-Brown
President, Open Society Foundations, former UN deputy secretary-general

The investments needed to combat climate change and enable the transition to a green economy will be immense, but the financial means of delivering this ambition remain lacking. That ambition has only been increased by the agreement at COP27 for a new Loss and Damage fund to redress the impact of climate change on developing countries. How is fresh finance generated without just shuffling an inadequate total from one donor pocket to another? Demands to lift the international finance available for development and climate change to trillions of dollars a year are not achievable by the international financial institutions (IFIs), to which such a task might normally be entrusted; they have shown themselves only able to deliver billions of dollars at best. The constraints of the IFIs' business models – reflecting their capacity, ownership and staff culture – are constantly noted, but even their critics shy away from the logical conclusion: start again; design a new institution.

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132 HM Treasury (2021), 'G7 Finance Ministers and Central Bank Governors Communiqué', 5 June 2021, https://www.gov.uk/government/publications/g7-finance-ministers-meeting-june-2021-communique/g7-finance-ministers-and-central-bank-governors-communique.
133 The proposal put forward by the German G7 presidency in mid-2022 would potentially include coordination on climate-related central banking and financial regulation, an investment taxonomy, and mandatory transition plans for financial institutions. G7 Germany (2022), 'G7 Statement on Climate Club'.

This reticence reflects the state of the world's politics, which makes agreement around the design and ownership of such an institution seem impossible. But what if a group of like-minded countries designed and launched a 'climate finance institution' – a CFI instead of an IFI, one might say – that could deliver trillions of dollars to finance a green transition? Would other countries stay out – particularly if its ownership represented a cooperative model reflecting today's geo-economic realities rather than the post-colonial structures of the existing institutions? The incentives to join the new institution would be huge, as all countries are confronted with the shared existential challenge of climate change.

Such an institution would deploy the partial paid-in capital and guarantee model of the World Bank, to allow it to borrow in the markets at favourable rates. This would allow governments to ensure a flow of funds many times greater than those available via grant finance, without in many cases having to record the guarantees as commitments on their own books.

Funds raised by the new CFI would then be multiplied a second time by their use in blended finance form, thereby leveraging investment flows from global savings into public–private green investment pools.

Some of those involved in the research for this paper have undertaken to develop a short blueprint for such an institution. This blueprint could be seen as a provocation to the prevailing system, perhaps – but a necessary one, given the current lack of ambition in existing IFIs.

07 Closing the digital infrastructure and connectivity gap

Achieving universal internet connectivity will require significant investment in digital infrastructure – including for commercially unviable locations. For this to happen, a wider investor base, more powerful financing tools, an enabling policy environment and better coordination systems must all be developed.

Marianne Schneider-Petsinger

Introduction: Closing multiple digital gaps

Digital infrastructure and connectivity feature prominently in 'build back better' initiatives to boost post-pandemic economic recovery and resilience – understandably so, given the centrality of digital tools in modern society. Internet access is vital for economic growth, as it can increase productivity and improve access to markets and information. Digital technologies can be leveraged to widen social inclusion. The catalytic role of digital connectivity in sustainable development is also recognized in the UN's Sustainable Development Goals (SDGs), and articulated in the stated aim of the UN's Roadmap for Digital Cooperation of 'achieving universal connectivity by 2030'.[134]

But the ability to connect remains profoundly unequal. While the number of people using the internet surged to 4.9 billion in 2021, following the connectivity boost associated with increased online activity during the COVID-19 pandemic,

134 United Nations (2020), *Report of the Secretary-General: Roadmap for Digital Cooperation*, https://www.un.org/en/content/digital-cooperation-roadmap.

37 per cent of the world's population have never used the internet. Of those 2.9 billion people who are still offline, 96 per cent live in developing countries.[135] This gap in internet access between high- and low-income countries is usually referred to as the 'digital divide'.

At the same time, efforts to build information and communication technology (ICT) infrastructure and strengthen digital connectivity need to take into account the reality that the digital divide is not a single gap. Rather, it consists of multiple – and often interrelated – sub-gaps. For example, people in rural areas are half as likely to use the internet as those living in urban areas.[136] There is also a gender gap, with more women than men remaining offline (particularly in least developed countries).[137] Generational and educational gaps contribute to the overall digital divide.[138]

And even among the 4.9 billion people identified as internet 'users', the ability to connect regularly and meaningfully remains unequal. Key factors determining internet access and usage include the affordability of devices and services, as well as the level of digital skills.[139] Meaningful connectivity also implies being able to access and transfer data freely and securely, both domestically and across borders. Breaches of data privacy, the use of surveillance technologies, and the spread of misinformation and harmful online content present threats to meaningful connectivity.

In sum, closing the digital divide involves addressing both gaps in access (i.e. linked to digital infrastructure and network coverage) and gaps in adoption (i.e. actual usage). This chapter focuses primarily on the infrastructure gap, partly because the 'build back better' movement emphasizes investment in digital infrastructure and technology, and also because internet access is a necessary (though insufficient) condition for narrowing the digital gap.

The International Telecommunication Union (ITU) estimates that $428 billion in investment will be required over the period 2020–30 to provide the world's unconnected population with access to broadband internet.[140] Comparable figures from the Global Infrastructure Hub – a G20 initiative – indicate that there is a $1 trillion gap between the cumulative investment expected (on current trends) in telecommunications infrastructure over the period 2016–40 and the investment needed.[141] The most important funding gaps are expected in sub-Saharan Africa, South Asia and the East Asia/Pacific regions, with the specific investment requirements and technology options – from wireless broadband to fibre and satellite – varying between regions and countries.[142]

135 International Telecommunication Union (ITU) (2021), *Measuring digital development: Facts and figures 2021,* https://www.itu.int/en/ITU-D/Statistics/Documents/facts/FactsFigures2021.pdf.
136 In 2020, the share of the global population using the internet was 76 per cent in urban areas and 39 per cent in rural areas. See ITU (2021), *Measuring digital development*.
137 Globally, 62 per cent of men and 57 per cent of women were using the internet in 2020. See ITU (2021), *Measuring digital development*.
138 In 2020, 71 per cent of the world's population aged 15–24 used the internet, but only 57 per cent of those in all other age groups did. See ITU (2021), *Measuring digital development*.
139 ITU (2022), *Global Connectivity Report 2022*, https://www.itu.int/itu-d/reports/statistics/wp-content/uploads/sites/5/2022/06/22-00399A_WTDC_Connectivity-report_Executive_summary.pdf.
140 ITU (2020), *Connecting Humanity: Assessing investment needs of connecting humanity to the Internet by 2030*, https://www.itu.int/dms_pub/itu-d/opb/gen/D-GEN-INVEST.CON-2020-PDF-E.pdf.
141 Global Infrastructure Hub (2021), 'Forecasting infrastructure investment needs and gaps', https://outlook.gihub.org.
142 ITU (2020), *Connecting Humanity*.

Closing these financing gaps will require a significant shift in how elements of the international system work together. It will require leveraging public and private finance, as well as increasing collaboration between G20 members and the rest of the world.

The role of private investment and mobilized private finance

Mobilization of private capital has been a consistent theme of 'build back better' and similar post-pandemic recovery initiatives. And at first sight, engaging the private sector in the rollout of digital infrastructure does not seem to be a major problem. In fact, traditionally the private sector has been the primary investor in ICT infrastructure. For example, the current 4G coverage around the globe has been financed mainly by private capital – including investments by network operators, tower companies and internet service providers.[143] It is expected that the private sector will meet $288 billion of the $428 billion investment requirement identified by the ITU (see above), while public sector money will principally target areas that are not (or not deemed to be) commercially viable.[144]

The current private sector-led investment model faces numerous obstacles. On the supply side, the deployment of infrastructure is associated with high costs and/or high risks due to the challenges of 'last-mile' telecommunications connections in remote areas.

However, in reality the current private sector-led investment model faces numerous obstacles. On the supply side, the deployment of infrastructure is associated with high costs and/or high risks due to the challenges of 'last-mile' telecommunications connections in remote areas.[145] Moreover, most of the capital needed for ICT infrastructure is traditionally debt-financed, but this source of capital is not readily available in low- and middle-income countries.[146] On the demand side, the lower incomes and/or lack of digital skills of end-users in these countries are deterrents to current and projected take-up of service – this reinforces the reluctance of the private sector to invest in networks in remote areas.[147]

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143 ITU (2021), *Financing Universal Access to Digital Technologies and Services*, https://www.itu.int/dms_pub/itu-d/opb/pref/D-PREF-EF-2021-ECO_FIN-PDF-E.pdf.
144 See ITU (2020), *Connecting Humanity*. A similar figure is mentioned in Bamford, R., Hutchinson, G. and Macon-Cooney, B. (2021), *The Progressive Case for Universal Internet Access: How to Close the Digital Divide by 2030*, Tony Blair Institute for Global Change, https://institute.global/sites/default/files/articles/The-Progressive-Case-for-Universal-Internet-Access-How-to-Close-the-Digital-Divide-by-2030.pdf.
145 ITU (2021), *Financing Universal Access to Digital Technologies and Services*.
146 Cheney, C. (2022), 'USAID initiative is mobilizing the private sector to fund connectivity', Devex, 28 April 2022, https://www.devex.com/news/usaid-initiative-is-mobilizing-the-private-sector-to-fund-connectivity-103135.
147 ITU (2022), *Global Connectivity Report 2022*.

Where private investment is insufficient, the public sector has an important role to play – both in complementing the finance available from the private sector and in creating an enabling environment to attract more private investment. 'Blended finance' is a potentially useful tool in this context. It is defined as 'the strategic use of (development finance and philanthropic) funds to mobilise private capital flows to emerging and frontier markets'.[148]

Compared to other sectors such as energy, construction or banking, ICT has not received the same attention from development finance institutions (DFIs), multilateral development banks (MDBs) or bilateral development finance providers. Of the $50 billion per year, on average, mobilized from the private sector by official development finance interventions for development in 2018–20, only $0.7 billion per year targeted the ICT sector.[149] As ICT infrastructure projects become more complex and costly, and as the internet becomes more ubiquitous, there is an urgent need to leverage the roles of the private and public sectors more effectively to fund ICT infrastructure.

Existing minilateral and multilateral efforts

The G7 and G20 have acknowledged the digital divide, and have launched efforts to promote universal internet access. For example, digital connectivity is one of the four pillars of the G7's Partnership for Global Infrastructure and Investment (PGII), launched in June 2022 as an apparent update to the 2021 Build Back Better World (B3W) Partnership.[150] One aim of the PGII is to build secure ICT networks and infrastructure 'to power economic growth and facilitate open digital societies'.[151] Together, the G7 partners aim to mobilize $600 billion by 2027 for the PGII, with the US committed to raising $200 billion across all four pillar areas.[152]

As part of President Joe Biden's initiative to strengthen global infrastructure and enable digital connectivity, USAID launched Digital Invest in 2022. This new blended finance programme seeks to leverage $3.45 million in public funding to secure up to $335 million in private capital for internet service providers and financial technology companies in Africa, Asia and Latin America.[153] The EU's Global Gateway, which aims to generate infrastructure development investments of up to €300 billion in the period 2021–27, also targets digital infrastructure as a key sector.

148 OECD/World Economic Forum (2015), *A How-To Guide for Blended Finance*, https://www3.weforum.org/docs/WEF_How_To_Guide_Blended_Finance_report_2015.pdf.
149 OECD (undated), 'Amounts mobilised from the private sector for development', https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/mobilisation.htm (accessed 5 Oct. 2022); also see related infographic: https://www.tossd.org/docs/Infographic_Mobilised_Private_Finance_TOSSD.pdf.
150 The White House (2022), 'Memorandum on the Partnership for Global Infrastructure and Investment', 26 June 2022, https://www.whitehouse.gov/briefing-room/presidential-actions/2022/06/26/memorandum-on-the-partnership-for-global-infrastructure-and-investment.
151 The White House (2022), 'Fact Sheet: President Biden and G7 Leaders Formally Launch the Partnership for Global Infrastructure and Investment', 26 June 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/06/26/fact-sheet-president-biden-and-g7-leaders-formally-launch-the-partnership-for-global-infrastructure-and-investment.
152 Ibid.
153 USAID (2022), 'USAID launches digital invest program to mobilize private capital for digital finance and internet service providers in developing markets as part of President Biden's global infrastructure initiative', 27 April 2022, https://www.usaid.gov/news-information/press-releases/apr-27-2022-usaid-launches-digital-invest-program-mobilize-private-capital.

The G20 has played an important role over the years in efforts to harness the digital economy as a driver of economic growth and development.[154] In order to encourage digital infrastructure and connectivity efforts across G20 members and also with the rest of the world, the G20 – in close cooperation with the OECD – developed 'Guidelines for Financing and Fostering High-Quality Broadband Connectivity for a Digital World' in 2021.[155] Digital transformation was also one of the 2022 Indonesian G20 presidency's three key pillars, and the G20 has reconfirmed a commitment to address the digital divide and boost digital infrastructure investments.[156] But the G20 is unlikely to find a consensus on related digital connectivity issues given clear divisions between members, for example on data regulation and cross-border data flows. With India – a country that is enacting data localization requirements – holding the G20 presidency in 2023, it will be easier for G20 members to find common ground on issues such as increasing digital infrastructure investment and supporting digital skills.

Mobilizing finance and creating an enabling environment for digital infrastructure are also part of efforts by the World Bank. The Digital Development Partnership (DDP), administered by the World Bank, brings together public and private sector partners to catalyse support to low- and middle-income countries. In 2021, the DDP's 'lending leverage' reached $9 billion, meaning that every dollar of donor funding generated around $950 in further lending.[157]

Other key multilateral initiatives include the UN secretary-general's Roadmap for Digital Cooperation, mentioned above, and the Broadband Commission for Sustainable Development. The latter is a joint initiative by the ITU and the United Nations Educational, Scientific and Cultural Organization (UNESCO) to promote internet access. With numerous actors involved and initiatives under way, greater collaboration among all stakeholders is required.

China's role in global digital infrastructure financing and standard-setting

Efforts by the US, Europe and other G7 partners have to be seen in the context of competition with China. At the same time, the world's leading democracies still cooperate with China on digital infrastructure and connectivity issues in key international forums – including the above-mentioned efforts at the G20.

154 During China's presidency of the G20 in 2016, the G20 Digital Economy Development and Cooperation Initiative was launched. During Germany's presidency in 2017, the G20 Digital Economy Task Force (DETF) was created; the DETF was later transformed into the Digital Economy Working Group to bridge the digital gap through more solid collaboration.
155 Italian G20 Presidency (2021), 'G20 Guidelines for Financing and Fostering High-Quality Broadband Connectivity for a Digital World', https://www.mef.gov.it/inevidenza/2021/article_00064/G20-Guidelines-for-Financing-and-Fostering-High-Quality-Broadband-Connectivity-for-a-Digital-World.pdf.
156 Indonesian G20 Presidency (2022), 'Overcoming the Digital Gap, Communications and Informatics Minister Encourages Continued Discussion on Digital Connectivity', 17 May 2022, https://g20.org/overcoming-the-digital-gap-communications-and-informatics-minister-encourages-continued-discussion-on-digital-connectivity.
157 World Bank Group (2021), *Digital Development Partnership: Annual Review 2021*, https://indd.adobe.com/view/2d9bd205-6961-45e3-b6a6-c1518de37e92.

China's 'Digital Silk Road' (DSR) was launched as a component of the Belt and Road Initiative (BRI) in 2015. It focuses on financing ICT infrastructure in many countries of the Global South. While determining exact investment figures is difficult, one estimate is that 'Chinese ICT infrastructure financing across Africa surpassed the combined funds from African governments, multilateral agencies, and G7 nations' in 2017.[158] More recently, China's Global Development Initiative from 2021 includes digital economy and connectivity aspects.[159]

Chinese-led investments can help fill the infrastructure investment gap in the Global South. But Chinese-led investments in ICT infrastructure have also raised multiple concerns in the West, including related to Beijing's role in promoting critical technologies such as 5G networks and setting technology standards, which could pose risks for security and human rights.

China is playing a leading role in international standard-setting bodies. For example, between 2015 and 2022, Zhao Houlin of China was secretary-general of the ITU. This specialized agency of the UN is responsible for issues related to ICT, including standard-setting for critical technologies and 5G regulatory activities. An election for a new secretary-general in September 2022 was widely seen as a pivotal moment both for the ITU and the future of digital communications, as it effectively pitted two visions of the internet – an open versus a state-controlled one – against each other. In the event, the US candidate, Doreen Bogdan-Martin, was elected, defeating Rashid Ismailov of Russia.[160]

In the ICT sector as elsewhere, the world's leading democracies need to carefully manage competition and cooperation with China. On the one hand, development initiatives should be considered separately from other areas of geopolitical competition. But on the other hand, critical infrastructure and standard-setting related to digital technologies are at the heart of the tensions between Western countries and China. The G20 is thus a very important forum for engagement, and for balancing sometimes conflicting imperatives around global interoperability and national security.

What more needs to be done

While important building blocks and global initiatives are in place to close the funding gap for ICT infrastructure in low- and middle-income countries, what has been missing is the political leadership to drive this agenda forward. The G20 can and should play a critical role in advancing and implementing ICT development in the widest sense, and in this context this chapter proposes the following policy recommendations:

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158 Arcesati, R. (2020), 'The Digital Silk Road is a development issue', Merics, 28 April 2020, https://merics.org/en/short-analysis/digital-silk-road-development-issue. Based on Infrastructure Consortium for Africa (2018), *Infrastructure Financing Trends in Africa – 2017*, p. 69, https://www.icafrica.org/fileadmin/documents/Annual_Reports/IFT2017.pdf.
159 Ministry of Foreign Affairs of the People's Republic of China (2021), 'Xi Jinping Attends the General Debate of the 76th Session of the United Nations General Assembly and Delivers an Important Speech', 22 September 2021, https://www.mfa.gov.cn/ce/cegv/eng/zgyw/t1909172.htm.
160 ITU (2022), 'Member States elect Doreen Bogdan-Martin as ITU Secretary-General', press release, 29 September 2022, https://www.itu.int/en/mediacentre/Pages/PR-2022-09-29-ITU-SG-elected-Doreen-Bogdan-Martin.aspx.

Recommendation 1: Broaden the base of financial contributors and enhance the role of MDBs

Options to broaden the base of ICT investors can focus both on the private and public sectors, and could include recruiting new private actors such as digital companies with an e-commerce focus.[161] But given that ICT infrastructure investment is driven by the private sector, this model has limits. Thus, new emphasis needs to be placed on leveraging public financing – especially for commercially unviable ICT infrastructure investments in remote areas and digital skills development.

In this regard, the role of MDBs can usefully be enhanced. MDBs can scale up both public and private funding for priority issues. Because the ICT sector has traditionally not been at the focus of their financing efforts, MDBs should make connectivity a new funding priority area.[162] A first step would be to increase MDBs' own capital commitments towards the ICT sector. But the considerable capabilities of MDBs can also be harnessed more widely to strengthen cooperation between the public and private sectors. In their investment mobilization efforts, MDBs should continuously emphasize the strong link between internet access and the SDGs.[163]

Recommendation 2: Expand the financial toolbox and reform UASFs

Blended finance is not new to the financing toolbox for ICT investment. Existing mechanisms include some that use loans, grants, guarantees or subsidies. Financing can be delivered through structured funds such as 'universal access and service funds' (UASFs). UASFs seek to extend network coverage into remote areas, and their funding is usually linked to levies on telecommunications companies.

However, UASFs have a mixed track record and need reform.[164] With approximately 100 countries having operational UASFs, there is no one-size-fits-all approach.[165] Modernizing UASFs could involve expanding the scope of digital technologies that can be supported by such financing tools, and widening the range of eligible beneficiaries. Most UASFs are currently funded via mandatory contributions, but a new approach to funding should go beyond reviewing the level of fees imposed. Instead, sources of funding from industry should be considered as 'anchor funds' to mobilize investment from other actors. In some instances, reform of UASFs needs to be targeted at building trust by improving fund administration, transparency and accountability.

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161 For a similar proposal, see ITU (2022), *Global Connectivity Report 2022*.
162 A similar suggestion is made by the OECD. See OECD/G20 (2021), *Bridging digital divides in G20 countries: OECD Report for the G20 Infrastructure Working Group*, https://www.oecd-ilibrary.org/docserver/35c1d850-en.pdf?expires=1660659342&id=id&accname=guest&checksum=03763EF9FA35EA8611C51C9487A4E5C0f.
163 This recommendation draws on the following paper: World Wide Web Foundation and Alliance for Affordable Internet (2018), *Closing the Investment Gap: How Multilateral Development Banks Can Contribute to Digital Inclusion*, https://a4ai.org/wp-content/uploads/2018/04/MDB-Investments-in-the-ICT-Sector.pdf.
164 Williams, M. and Bachiri, Q. (2021), 'Financing options for the future of digital', in OECD (2021), *Development Co-operation Report 2021,* https://www.oecd-ilibrary.org/sites/122f062a-en/index.html?itemId=/content/component/122f062a-en#section-d1e38014.
165 The reform ideas for UASFs proposed here draw on ITU (2021), *Financing Universal Access to Digital Technologies and Services.*

New financing arrangements are emerging, including bond financing. Cryptocurrencies are also starting to be used for development financing.[166] Such innovative instruments can play a role in expanding the financial toolbox; however, their benefits and risks are still being evaluated.

Recommendation 3: Optimize non-financial instruments to create an enabling environment

Governments indirectly influence the investment decisions of the ICT sector through the regulatory and legal environment, which affects companies' actual and perceived costs and the risks of technology deployment and operation. Non-financial incentives can be put in place to facilitate investments in connectivity. These include urban planning (such as 'dig once' and 'dig smart' policies) and the streamlining of approval processes for ICT infrastructure development.

Non-financial incentives can be put in place to facilitate investments in connectivity. These include urban planning (such as 'dig once' and 'dig smart' policies) and the streamlining of approval processes for ICT infrastructure development.

The use of broader policy tools (such as taxation) is particularly important for the ICT sector because rapid technological change is challenging existing regulation, business models and market structures. Keeping legal and regulatory frameworks up to date – and even promoting so-called 'anticipatory governance'[167] models that apply foresight to technological and societal developments through engagement across different sectors and with the public – can help countries to attract ICT investment. Greater international cooperation can facilitate the exchange of best practices.

Recommendation 4: Strengthen coordination between actors in the digital infrastructure space

The range of actors – including consumers, the private sector, national and subnational governments, DFIs, and bilateral and multilateral donors – in the digital technology space has rendered cooperation complex. Interests

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166 For models involving the use of innovative instruments such as digital bonds for development funding and cryptocurrencies to fund capacity-building, see European Investment Bank (2021), 'EIB issues its first ever digital bond on a public blockchain', 28 April 2021, https://www.eib.org/en/press/all/2021-141-european-investment-bank-eib-issues-its-first-ever-digital-bond-on-a-public-blockchain; and UNICEF (2021), 'UNICEF and Giga Funding Opportunity', https://www.unicef.org/innovation/venturefund/funding-opportunity-blockchain-capacity-building.
167 OECD (undated), 'Technology governance', https://www.oecd.org/sti/science-technology-innovation-outlook/technology-governance.

and agendas around digital infrastructure development are diffuse. Better coordination between the public and private sectors, and also between domestic and international actors, is needed to reduce systemic redundancies and maximize the impact of investments to improve the quality and spread of ICT infrastructure.

International forums, such as the OECD and G20, already play a critical role in exchanging information, and in developing guidance on best practices related to digital infrastructure finance. They are also useful for providing multi-stakeholder platforms for cooperation. But, as discussed previously, there is significant scope to enhance the role of MDBs in leading the financing of ICT infrastructure expansion. In addition to making digital investments a priority, MDBs could strengthen collaboration to explore co-financing opportunities and share expertise. The global presence of MDBs and their operations across multiple sectors put them in a unique position to embed digital connectivity initiatives in a system-wide approach.

Other sectors, for example transportation and energy, often require civil works such as those for laying fibre-optic cables. Cross-sectoral collaboration could bundle digital infrastructure deployment with major works already planned or in progress in other sectors, thus avoiding duplication, minimizing costs and reducing environmental impact. Similar benefits could be achieved by strengthening cross-border coordination between neighbouring countries in the rollout of digital infrastructure.[168]

Moreover, multilateral cooperation on standards (e.g. linked to financial transparency and environmental sustainability) could help attract private sector finance to investment in ICT infrastructure abroad. In this regard, the Blue Dot Network – a multi-stakeholder initiative formed by the US, Japan and Australia that certifies infrastructure development projects worldwide – should expand its membership, for example by including the EU and UK.

Conclusion

In sum, if the G20 members do not significantly scale up financing and identify innovative initiatives to leverage both public and private funding for ICT infrastructure and connectivity, the existing digital gaps will only widen. But if the G20 can rise to the challenge, universal and meaningful connectivity can contribute to sustainable economic growth, social inclusion and climate action. There has never been a more pressing time to put internet access at the forefront of economic development, and to mobilize concerted effort from the public and private sectors.

168 Some of the ideas presented here are inspired by the 'G20 Guidelines for Financing and Fostering High-Quality Broadband Connectivity for a Digital World' from 2021.

08 Bridging the trust deficit

A lack of trust between developing countries and donors makes it hard to mobilize sufficient investment for a sustainable global recovery. Co-creation of development initiatives and accountability surrounding these initiatives can help 'reset' relations between partners. This is essential if key development objectives are to be met.

Mark Malloch-Brown
and Leslie Vinjamuri

Introduction: a lack of trust as a barrier to mobilizing capital

Efforts by the G7 to close the 'global infrastructure gap' face a worsening international context marked by a cascading series of crises. At the G7 summit in Cornwall in June 2021, US president Joe Biden announced the Build Back Better World (B3W) Partnership, an initiative to stimulate infrastructure investment in low- and middle-income countries. Within months, Russia had invaded Ukraine and the ensuing war spurred food, fuel and debt crises across the developing world, creating an urgent need for relief and further complicating prospects for longer-term economic development and a transition away from fossil fuels. When the G7 reconvened in Germany, one year later, and announced the Partnership for Global Infrastructure and Investment (PGII), it confronted a radically altered international environment.

The PGII, though, does not address the fundamental nature of the challenge. Like many previous initiatives, it is designed to leverage public development assistance to mobilize private capital. By 2027, the G7 aims to raise $600 billion in global infrastructure investments. This is not nearly enough: underinvestment in infrastructure in the developing world is estimated at over $40 trillion.[169] At the same time, the problem is more than simply a matter of scale. A trust deficit continues to inhibit efforts to increase public and private finance. And the current geopolitical and domestic contexts are exacerbating this deficit. Russia's ongoing war in Ukraine and the Western response to it have antagonized developing countries; competition between the US and China has undermined prospects for development cooperation between these two great powers; and inflation in the advanced democracies, compounded in Europe by an energy crisis, has reduced the political will in Western capitals to increase spending on development assistance.

This trust deficit plagues international development cooperation more broadly, and inhibits effective partnerships between developing countries in the Global South, private lenders, and developed-country governments in the Global North. Even where financial capital is abundant, its potential to overcome development challenges is limited as a result. The ability to restore trust is thus a crucial ingredient in improving development outcomes.

The problem has at least three dimensions. The first centres on perceptions of fairness, and concerns that developing countries are more exposed to the unintended but nonetheless negative effects of principled Western policies – whether on climate change or on economic sanctions against Russia – than are the countries making them. For instance, in the current geopolitical context, some developing countries charge the West with hypocrisy for sanctioning Russia while failing to protect them from the resultant costs, manifest in surging food, fuel and fertilizer prices. (The argument is reinforced by the reality that inflation is even higher in emerging markets and developing countries than it is in advanced economies, with the International Monetary Fund projecting a 14.2 per cent rise in consumer prices in low-income countries in 2022.[170])

This trust deficit plagues international development cooperation more broadly, and inhibits effective partnerships between developing countries in the Global South, private lenders, and developed-country governments in the Global North.

The second dimension of the trust deficit is the politicized framing of development relationships. In rich countries in the Global North, populist politicians vociferously question the legitimacy of development assistance in a world where domestic priorities are insufficiently funded. They also highlight the risk of public money being stolen by elites in aid recipient countries, instrumentalizing these fears

169 The White House (2021), 'FACT SHEET: President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership', press release, 12 June 2021, https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/12/fact-sheet-president-biden-and-g7-leaders-launch-build-back-better-world-b3w-partnership.
170 International Monetary Fund (IMF) (2022), *World Economic Outlook: Countering the Cost-of-Living Crisis*, October 2022, p. 132, https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022#Overview.

for political gain and thus further deterring government spending on foreign aid. In the Global South, meanwhile, recipient-country governments and publics resent what they see as paternalistic instruction and often coercive donor conditionality on the proper use of assistance; this resentment is fed by a history of post-colonial recriminations.

A third dimension is the reticence of the private sector, which often does not trust developing-country borrowers to repay their debts. Financial institutions withhold credit except at usurious rates that overprice risk and make borrowing fiscally unsustainable. Persistent debt crises almost inevitably follow, sometimes even in well-managed countries. Indeed, a track record of sound economic stewardship can sometimes increase the problems, allowing governments to borrow more in the first instance but then causing a harder financial shock. Debt distress in Ghana, which is in discussions with the IMF about a potential 17th bailout, is a current example.[171] Private sector lenders lack confidence in the ability of public lending to create the right environment for private capital, thus rendering government intervention less effective as a potential catalyst for private finance.

These three dimensions of the trust deficit are compounded and made worse by an overarching lack of transparency. As alluded to above, corruption has sometimes been allowed to grow unchecked in recipient countries, with aid failing to reach those who need it most. In some cases, billions of dollars in development assistance never finds its way out of the treasuries or government agencies of recipient-country capitals. In other cases, development funds have been siphoned into offshore bank accounts. A 2020 paper by the World Bank's Development Research Group found that 'aid disbursements to highly aid-dependent countries coincide with sharp increases in bank deposits in offshore financial centers known for bank secrecy and private wealth management, but not in other financial centers'.[172]

This dysfunctional dynamic prevents much-needed action when and where it is needed most. To be blunt, why should donors continue to pour money into countries when it is difficult to determine how such funds are being used and whether they are being spent properly? An absence of transparency impedes any hope of accountability, and so saps progress on issues that require international cooperation, from public health to climate change to global economic policy coordination.

171 *The Economist* (2022), 'Ghana, an oft-lauded African economy, is back for a 17th bail-out', 5 August 2022, https://www.economist.com/middle-east-and-africa/2022/08/05/ghana-an-oft-lauded-african-economy-is-back-for-a-17th-bail-out; IMF (2022), 'Key Questions on Ghana', updated 25 September 2022, https://www.imf.org/en/Countries/GHA/ghana-qandas.
172 Andersen, J. J., Johannesen, N. and Rijkers, B. (2020), *Elite Capture of Foreign Aid: Evidence from Offshore Bank Accounts*, Policy Research Working Paper 9150, World Bank Group, February 2020, https://documents1.worldbank.org/curated/en/493201582052636710/pdf/Elite-Capture-of-Foreign-Aid-Evidence-from-Offshore-Bank-Accounts.pdf.

Global consequences: no solidarity on climate policy

Climate policy exemplifies the nature of the challenge. Tackling climate change will require the Global South and Global North to work together to reduce greenhouse gas emissions. The world, it has been argued, needs to spend $3–6 trillion a year on climate-related measures between now and 2050 to stay on a '1.5°C pathway' (that is, limiting the rise in global temperature to 1.5°C relative to pre-industrial levels), but annual spending currently totals only $630 billion. Moreover, of this amount, very little goes to developing countries.[173] A combination of domestic constraints in advanced economies – cleaning up the 'neighbourhood' is more politically palatable than cleaning up the world – and donor distrust of the integrity of government spending plans in the Global South makes securing the necessary additional funding highly challenging. The failure to this day of developed countries to deliver on the pledge made in Copenhagen, at the COP15 climate conference in 2009, to provide $100 billion each year to developing countries by 2020 has accentuated a sense of betrayal. The recent adoption in principle at COP27 in Egypt of a 'loss and damage' finance facility addresses a long-standing Global South complaint – and source of broken trust. Yet like so many previous COP promises, it comes without a number or a plan; just a commitment to report back next year.

Already, higher oil, gas and food prices in the wake of the Russian invasion of Ukraine threaten the plan for a 'just transition' from fossil fuels to renewable energy – a plan which anticipated developed countries helping fund the energy transition in poorer ones. 'There is a risk that some countries, especially those without adequate funding, might, under pressure, set a course for high-emission, expensive energy in the future,' the UN Global Crisis Response Group on Food, Energy and Finance concluded in the summer of 2022.[174] At COP27, African countries – led by the current head of the African Union, President Macky Sall of Senegal – pressed for a much bigger role for the development of African gas as a transition fuel. Part of the rationale is that African leaders see a double standard: Europe reverting to traditional fossil fuel sources because of the energy crisis while developing countries are condemned to, in their leaders' eyes, unrealistic renewable options. Not just the financing of measures to address climate change, but the current political consensus around urgent action, hangs in the balance.

The West vs China: counterproductive rivalry

Alternative aid and development arrangements that take place outside the West's influence – not least China's provision of funds to developing countries through its Belt and Road Initiative (BRI) – are also stymied by an atmosphere

173 Georgieva, K. and Adrian, T. (2022), 'Public Sector Must Play Major Role In Catalyzing Private Climate Finance', IMF Blog, 18 August 2022, https://www.imf.org/en/Blogs/Articles/2022/08/18/public-sector-must-play-major-role-in-catalyzing-private-climate-finance.
174 United Nations (2022), *Global impact of war in Ukraine: Energy crisis*, UN Global Crisis Response Group on Food, Energy and Finance, Brief No. 3, August 2022, https://unsdg.un.org/resources/global-impact-war-ukraine-energy-crisis-brief-no3.

of rampant mistrust. Poorly designed, poorly executed BRI projects have left borrowing nations with unsustainable debts. China, consequently, has become increasingly coercive in seeking repayment. William Burns, director of the Central Intelligence Agency, identifies the economic crisis in Sri Lanka as a case in point:

> [A] place like Sri Lanka today – heavily indebted to China – which has made some really dumb bets about their economic future and are suffering pretty catastrophic, both economic and political, consequences as a result.
>
> That, I think, ought to be an object lesson to a lot of other players – not just in the Middle East or South Asia, but around the world – about having your eyes open about those kinds of dealings.[175]

Prospects for effective international development are further undermined by the existence of two separate systems, which exist in a context of heightened competition and deep mistrust, in the form of the Western- and Chinese-led assistance models respectively. It would be more constructive if the IMF and World Bank, which continue to be Western-led, worked collaboratively with the Chinese-led development banks – the Asian Infrastructure Investment Bank and the New Development Bank – rather than in opposition or in parallel as is frequently the case now. For example, Western donors could be encouraged to focus on the provision of services, especially in health and education, while Chinese stakeholders could scale up investment in climate-friendly, affordable infrastructure.

Perversely, the West's conception of China as an adversary has given a short-term boost to development initiatives, as competing efforts to raise finance and launch infrastructure projects have led to an increase in overall funding. The announcement at the 2022 G7 summit in Germany of a $600 billion infrastructure initiative (much of which depends on an ambitious and unrealized mobilization of private capital) is in part a bid to counter Chinese activity in similar areas.[176] However, this is not an efficient approach and it is unlikely to be sustainable.

So long as the US and China remain the two major stakeholders in the global economy, there will be a strong case for trying to segregate environmental and development cooperation from the two countries' wider competition – indeed, engagement in the development arena could have the added benefit of reducing overall geopolitical tensions, even if it is unlikely to eliminate them. For both governments, the underlying motivation for delivering aid to the developing world may remain one of competitive engagement, as Washington and Beijing seek to win friends and cement alliances. But suspicion and mistrust not only undermine the coordination of assistance towards a shared purpose, they also impair constructive relations with recipient-country leaders. The latter resent the feeling of being pushed into an exclusive choice between partnering with the US or China, and instead want to maximize their options in terms of support from the West, China and other donors alike.

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175 Ellis-Petersen, H. (2022), 'Sri Lanka braced for more unrest as new president vows crackdown on 'fascist' protests', *Guardian*, 21 July 2022, https://www.theguardian.com/world/2022/jul/21/sri-lanka-unrest-new-president-crackdown-protests.
176 G7 Germany (2022), 'G7 Summit at Schloss Elmau: The outcomes at a glance', 28 June 2022, https://www.g7germany.de/g7-en/current-information/g7-summit-outcomes-2058314.

Solutions for building trust

Three factors are especially critical and must be taken into account to make possible collective global action on today's agenda of big problems:

1. **Power.** Developing countries despair of an international financial system still run predominantly by Western donors, and which operates according to those donors' conditions and values. Despite efforts at progress, poorer countries continue to find themselves without a meaningful place at the table.

2. **Scale.** The present system has failed to adapt to the size of the development challenge, with needs far exceeding the funding available. The United Nations recently estimated that humanitarian crises would require UN agencies and their private partners to spend $48.7 billion in 2022, but together they have less than one-third of that sum on hand.[177] The funding shortfalls in the much larger development sector are greater still. While much of the debate has focused on public aid organizations, the lack of private capital – which brings both scale and visibility to development efforts – looms large. The combined value of government-supported projects represents a fraction of the resources available to Fortune 500 companies in the US, and to equivalent corporations in Europe, Asia and other parts of the world. In August 2022, Kristalina Georgieva, the managing director of the IMF, estimated that financial assets in private firms totalled $210 trillion, equivalent to about twice the GDP of the global economy.[178]

3. **Confidence.** Private investors lack confidence that allocating money for infrastructure projects in developing countries is worth their while. Meanwhile, public actors are wary of partnering with the private sector on deals which they fear will not benefit recipient-country citizens. Policymakers and aid managers in governments, the World Bank and regional development banks anticipate bad policies in target countries and are aware that corruption can be a barrier to effective assistance. This has created a downward spiral: support and financial sponsorship are eroded, which means less funding, which in turn causes a breakdown in coordination between donor staff and the officials in developing countries tasked with implementing aid programmes.

These three factors are interconnected. The absence of investor confidence limits the scale of investments achieved, which has the effect of crowding out the voice and undermining the negotiating power of developing countries. This in turn biases the system towards the status quo. The alternative is a 'reset' followed by the rebuilding of the current system along more effective and inclusive lines. It needs to be presented as the precondition for achieving the scale and ambition of solution required.[179]

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177 Fassihi, F. (2022), 'U.N. Faces Record Humanitarian Shortfall — but Not for Ukrainians', *New York Times*, 22 August 2022, https://www.nytimes.com/2022/08/22/world/middleeast/humanitarian-aid-gap-un.html?smid=nytcore-ios-share&referringSource=articleShare.
178 Georgieva and Adrian (2022), 'Public Sector Must Play Major Role in Catalyzing Private Climate Finance'.
179 Some have described the need for a 'global social contract' which would fundamentally redefine the development cooperation model in line with the new and pressing demands being placed on it. Shafik, M. (2021), *What We Owe Each Other: A New Social Contract*, UK: Penguin Random House.

The core task is to create incentive structures and social mechanisms that establish a basis for trust between public and private donors in the Global North and recipients in the Global South. Drawing on the evidence from examples of successful development, we stress two essential principles – co-creation and accountability – and emphasize the importance of adopting measures to strengthen the broader 'ecosystem' in which development takes place.

Co-creation

'Co-creation' between stakeholders in developing countries and the Global North involves recipients and donors working collectively to agree development programming. Co-creation facilitates co-ownership: the idea that all parties should have a meaningful stake in and responsibility for such programming. This in turn can facilitate more ambitious investment strategies and prevent the recurring cycles of austerity imposed by outsiders resulting in forced reductions in public spending in recipient countries.

Co-creation would imply a much more equitable process of negotiation between funding providers and recipient countries. There needs to be a shared definition of success – including what is meant by human development and a just energy transition – but much greater flexibility on strategies to get there.

This requires almost 'unlearning' development policy. It means addressing the fact that the 'Washington consensus' is hard-wired into the Western aid and development model, and still implicitly frames the crisis responses of organizations such as the IMF and World Bank. Although this straitjacket approach has been publicly repudiated, a conservative culture of investment protection continues to drive lending policy, impeding growth-focused alternative models. Some would argue that this tendency does not begin in the corridors of international financial institutions (IFIs), but in the economics lecture halls of leading research universities. In other words, development economics itself needs to be reimagined, and its new principles incorporated into mainstream policy thinking.[180]

What might co-creation look like in practice? For a start, it would imply a much more equitable process of negotiation between funding providers and recipient countries (including the latter's leaders and key stakeholders). There needs to be a shared definition of success – including what is meant by human development and a just energy transition – but much greater flexibility on strategies to get there. Recipient countries must own and drive these strategies.

180 One of the leading and long-standing exceptions to the dominance of neoliberal development economics is, of course, the thinking of Dani Rodrik.

An example of this sort of model can be seen in Indonesia, where the World Bank has supported the PNPM National Program for Community Empowerment with loans and technical assistance, using community-driven development as its guiding principle. This arrangement enables the anti-poverty objectives of the programme while building the capacity of civil society. Village facilitators – rather than technocrats in New York, Washington or London – recommend how block grants are used and help decide which projects are funded. Community members are 'in control of the planning, design, implementation and monitoring of project activities'.[181] The results have been encouraging: 'As a result of participation in the program, real per capita consumption gains were 9.1 percentage points higher among poor households in PNPM areas compared with control households.'[182]

What makes this example so instructive is that it combines co-creation with the building blocks of civil society. International organizations and providers of aid are engaged, but not dictating the terms or setting the agenda. Just as importantly, local members of the community are doing the hard work of pushing for transparency and accountability (see below) from their own governments.

Accountability

Acountability is essential for building trust, and the mechanisms for achieving this are well known: empowered legislatures; private sector due diligence; strong, politically independent IFIs; and a robust, independent local civil society. In the ideal circumstances, the presence of these elements would foster an environment of transparency that creates accountability. But in a world in which less than 25 per cent of people live in free societies, few investments take place in ideal circumstances. Still, pragmatism does not mean giving up on governance. Investments in civil society should be strategic, designed not only to support specific institutions but to create the wider conditions for more effective civil society engagement. Governments in the Global South should be encouraged to support this process through their own efforts at reform, corruption prevention and promotion of good governance. The upside is clear: the prospect of increased investments from donors who have access to information that can verify whether funds reach the intended targets. This shifts the requirement for accountability on to recipients of aid, giving them greater ownership of the issue.

To be sure, supporting civil society is a challenge. Risks of a popular backlash against civil society are pervasive. Civil society organizations, even local ones, are often seen by recipient-country publics as extensions of powerful states in the Global North – and thus as neither independent nor local. This makes society-level workarounds important. One method which could be integrated into the strategic toolkit of development assistance is to provide local citizens with the resources and capabilities they need to guide and grow local institutions. Support from organizations in the Global North would create a space for local

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181 PNPM Support Facility Jakarta (2012), *PNPM Rural Impact Evaluation*, pp. xi–xii, April 2012, https://documents1.worldbank.org/curated/en/543401468259751080/pdf/934210WP0PNPM000Box385397B00PUBLIC0.pdf.
182 Ibid.

initiative and control, enabling civil society to assume a larger role in co-creation while also creating a foundation for greater accountability. We can see this principle in practice in Jamaica, where the Jamaica Accountability Meter Portal (JAMP) has provided digital tools for citizens, the media and others to monitor everything from government procurement and contractor decisions to governance and regulatory policy. Using online tools and capacity-building expertise from the International Budget Partnership, JAMP leverages citizen engagement to remedy mismanagement and improve the performance and responsiveness of public agencies and elected officials.[183]

Ultimately, greater accountability is essential to encourage private investment. In the wake of the Panama Papers revelations in 2016 about offshore hidden assets and tax avoidance, the World Bank developed a loan programme in collaboration with Panamanian officials that emphasized tax transparency and anti-money-laundering provisions. These transparency-enhancing reforms resulted in improved tax collection, enhanced government revenue, and so an expansion of social assistance to reach 81 per cent of the extreme poor, up from 37 per cent previously.[184]

Part of the accountability solution could involve a ‘relaunch’ of the IFIs, so that they might function on a cooperative model in which recipients enjoyed a substantive stake in governance.

Many emerging markets are dependent on extractive industries and hydrocarbons, condemning their economies to repeated boom-and-bust cycles that contribute to what is widely known as the ‘resource curse’.[185] With improved local oversight and more robust civil society participation in these countries, sectors beyond natural resources could secure private capital, offering new opportunities for young people (and other cohorts) who often struggle to find employment.

Part of the accountability solution could also involve a ‘relaunch’ of the IFIs, so that they might function on a cooperative model in which recipients enjoyed a substantive stake in governance, as opposed to the present donor–beneficiary arrangement where power lies with donors. Too often IFI leaders have expressed a public commitment to more cooperative relationships, only to encounter resistance and inertia within their own institutions. The old economics remains ‘hard-wired’ into thinking at staff level. There is neither the commitment to sustainable growth nor sufficient respect for the principle of partnership with

183 International Budget Partnership (2021), ‘Building the tools for citizen accountability in Jamaica’, *Annual Report 2021: 25 years of making budgets work for people*, p. 26, https://internationalbudget.org/wp-content/uploads/IBP-Annual-Report-2021-Final.pdf.
184 World Bank (2021), ‘Clearing a Path Toward Transparency, Inclusion, and Sustainability in Panama’, Results Briefs, 14 April 2021, https://www.worldbank.org/en/results/2021/04/14/clearing-a-path-toward-transparency-inclusion-and-sustainability-in-panama.
185 Frankel, J. (2012), ‘The Natural Resource Curse: A Survey of Diagnoses and Some Prescriptions’, CID Working Paper 233, Center for International Development at Harvard University, April 2012, https://www.hks.harvard.edu/centers/cid/publications/faculty-working-papers/natural-resource-curse.

recipient-country leaders. The ultimate goal should be for recipient countries to work in partnership with lenders to develop plans which are costed and investable, transparent and accountable.

Conclusion

Co-creation and accountability are essential for closing the trust deficit and rendering economic gains more sustainable while spreading the benefits of growth more equitably. Amid multiple global and local development finance challenges, the individual examples of co-creation and accountability highlighted earlier in this chapter provide some nascent reasons for hope. A further example is the inspiring activism of Barbados where, under Prime Minister Mia Mottley's leadership, the government is offering greater accountability to its citizens while securing a real place at the negotiating table for its policymakers.[186] Mottley has put climate change at the centre of debt relief and financial support negotiations with the IMF, and went directly to Christine Lagarde, the fund's former managing director, to do so. This illustrates how small countries can meaningfully influence the debate and challenge donor-centric patterns of development relationships.

There are signs, too, that international institutions are coming around to the need for reform. António Guterres, the UN secretary-general, has made the case for a renewed 'social contract', and 'for Multilateralism 2.0 to demonstrate a practical "hard interest" as well as a "values case" for why international cooperation inclusively benefits individuals as well as states'.[187]

As the authors of this research paper argue, the resources exist in the public and private sectors to mount a more ambitious effort, but the enabling condition is trust. If trust can be put at the heart of development, this will enable a new level of ambition, and success can flow from there.

186 Lustgarten, A. (2022), 'The Barbados Rebellion: An Island Nation's Fight for Climate Justice', *New York Times*, 7 July 2022, https://www.nytimes.com/interactive/2022/07/27/magazine/barbados-climate-debt-mia-mottley.html.
187 Daws, S. (2021), 'Rebuilding trust is central to the UN's future', Chatham House Expert Comment, 25 March 2021, https://www.chathamhouse.org/2021/03/rebuilding-trust-central-uns-future.

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Cover image: G20 leaders at a tree-planting event on the sidelines of the G20 summit in Bali, Indonesia, November 2022.

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