



## **Financing for development and climate change post-2015**

Background paper for the  
High-Level Panel of Eminent Persons on the Post-2015 Development Agenda

Prepared by the Secretariat of the Sustainable Development Solutions Network

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Financing for development and climate finance are central but controversial issues that must be at the center of the deliberations of the High-Level Panel.<sup>1</sup> A compelling post-2015 framework must address how adequate public and private financing can be mobilized for investments in ending extreme poverty and in sustainable development. It must deal convincingly with the difficult issues of equity and efficiency in the context of a rapidly changing world economy that will look very different in 2030 than it does today. Since the world is changing profoundly, a financing framework for the post-2015 development agenda will need to consider structural changes in the way development and climate finance are mobilized and disbursed.

This paper describes the need for public and private financing of development and climate change. It is organized around four core questions: (i) What types of financing are required? (ii) What is wrong with today's development and climate finance? (iii) What might a sound framework for development and climate finance look like through to 2030? (iv) How could development and climate finance be disbursed more effectively? (v) What are the principal elements of a "global deal" on improving development and climate finance? In response to these questions, the paper proposes essential parameters for the public side of post-2015 development and climate finance, which could be integrated into the post-2015 development framework and – ultimately – the post-2015 goals, such as the Sustainable Development Goals.

The paper does not attempt to address all issues pertaining to development and climate finance. The paper describes the roles that public and private finance can play, and then maps out some plausible next steps for strengthening international public finance for development and climate change. The large and complementary agenda of how to mobilize more private finance for private investments is beyond the scope of this paper. Likewise, our focus is mainly on budgetary allocations. We will not address in detail the question of off-budget innovative financing such as airline fees.

## **I. Development and Climate Finance: The Complementarity of Public and Private Investments for Sustainable Development**

Financing can come in the form of private commercial funding that seeks a market-rate return or as non-commercial funding from governments and private donors who are willing to accept no or below-market rates of return. The fundamental distinction between "private" and "public" funding and their non-fungibility are often overlooked in discussions around development and climate finance. Yet, this distinction and opportunities for blending public and private finance are at the center of any viable post-2015 framework for development and climate finance.

Private finance can support investments in private assets, such as factories and machineries, provided they generate a financial return for their owner that is superior to the risk-adjusted cost of capital. Any spillovers or externalities will reduce the incentives for private financing. At the same time, most private investments depend heavily on public goods, such as stability and security, good infrastructure, a well-educated workforce, and public R&D financing.

Private finance requires an adequate risk-return profile. The richer a country or the higher its future income stream (e.g. following the discovery of natural resources), the easier it will be to mobilize private finance in the form of loans, bonds, equity, insurance products, risk guarantees, etc. Conversely, poor countries without specific streams of resource rents will not be able to attract adequate private finance since they lack the necessary wealth and income streams to pay back the investor. This lack of

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<sup>1</sup> See also the Rio+20 decision to launch an intergovernmental process to review financing needs and modalities for sustainable development (Art. 255-257).

“creditworthiness” of poor countries cannot be overcome simply through financial innovation and forms a key reason why low-income countries require official development financing.

Public investment covers areas where private, for-profit financing is intrinsically insufficient or impossible. Six areas that are usually referred to as “public goods” stand out for public development and climate finance:

**Sustainable Infrastructure.** Most network infrastructure (rail, roads, pipelines, power distribution, broadband fiber networks) has strong natural monopoly and/or public goods dimensions, requiring a combination of regulation and direct public financing. Simple cost recovery on network infrastructure is rarely appropriate, so that public financing is typically required. Public development finance assists poor countries to deploy network infrastructure that is vital for sustainable development.

**Social Services.** Most social services, including health care, early childhood development (e.g. safe childcare and pre-school), education, and job training, are considered “merit goods,” meaning that they should be available to all members of the society, rich and poor alike. These merit goods are typically described as “human rights,” or “basic human needs,” and are enshrined in the Universal Declaration of Human Rights. To ensure that merit goods are available to all, including the very poor, public financing is essential. For poor countries, official development assistance is needed to complement domestic resource mobilization so that national budgets can finance the necessary basic level of social services.

**Post-Conflict Assistance and Peace-building.** International assistance for peacekeeping, peace-building, post-conflict humanitarian aid, and early-post-conflict development, is needed because of the inherent weakness of governments and civil-society organizations in post-conflict conditions. Post-conflict assistance and peace-building are important public goods since stability benefits everyone in a country as well as neighboring countries and the world at large.

**Climate Change Mitigation and Adaptation.** As poor countries are besieged by climate shocks (storms, floods, droughts, heat waves, sea level rise, and other harms), they will need financial support for adaptation to ensure preparedness, response, and resilience. Part of this financing can be regarded as compensation to poorer countries for losses incurred as the result of greenhouse gas emissions by richer countries. Poor countries will also need incremental funding to adopt cleaner but more expensive energy technologies. Such investments in adaptation and mitigation in poor countries require substantial public co-financing.

**Biodiversity Conservation.** Biodiversity and ecosystem conservation are global public goods, and as such require a combination of regulation, market-based incentives (taxes and subsidies), and public investment in infrastructure and conservation.

**Technology Development and Diffusion.** Basic science and technological knowhow are “knowledge goods”, which have the property of being “non-rival.” Non-rival goods are those that can be used by one person without diminishing their accessibility to others. For-profit markets underprovide knowledge goods. Either they are made freely available (such as with basic scientific knowledge), or held by temporary monopolists protected by patents. Either way, the development and diffusion of technology is less than optimal, and the poor may be hurt the most. As a result, public (co-)financing is needed to help generate and diffuse new technologies. This will be especially important for sustainable development, since deep and rapid technological change will be the hallmark of success in achieving a sustainable-development trajectory. Global public financing will be needed to promote new sustainable technologies and to promote their rapid diffusion to low-income countries.

## The Special Role of Public-Private Partnerships

In almost all areas just mentioned, the private sector will play a direct and indeed often dominant role in delivery and implementation. Private businesses will deliver most investments in infrastructure and can play an important role in improving social service delivery. They can leverage public financing. Private companies are also major sources of R&D, early-stage deployment, large-scale production systems, and best practices for technology diffusion to low-income settings. Note, though, that even where the private sector can play a strong role in delivering public goods, their financing will overwhelmingly come from public sources with perhaps the notable exception of some infrastructure spending.

Today's markets do not provide adequate incentives for private businesses to contribute towards sustainable development. The key is to combine public financing, regulation, and private-market participation into an effective public-private partnership (PPP). Such PPPs can come in a variety of forms:

1. **Private provision on public contract.** The private sector may be the supplier on a publicly financed contract. This can be for R&D or for deployment of infrastructure.
2. **Market price corrections.** A variety of tax and subsidy corrections exist to provide incentives for the private sector in line with social costs and benefits. Examples include tax credits for investments in new (risky) technologies, feed-in tariffs for renewable energy, carbon pricing, and investment and export guarantees to high-risk countries.
3. **Differential pricing by the private sector.** The private sector may provide discounts or free supplies for products and services to low-income settings against a promise from governments to maintain (higher) pricing in all other markets. An important example for differential pricing is the marketing of essential medicines in developing countries, which has made a tremendous contribution to the fight against many infectious diseases including HIV/AIDS.
4. **Global fund mechanisms.** The Global Fund to Fight AIDS, TB, and Malaria (GFATM) and the Global Alliance for Vaccines and Immunizations (GAVI) are examples of public-private partnerships organized around technological delivery with public financing.
5. **Technology consortia.** The public sector may sponsor a consortium of private and public entities to carry out R&D and pre-commercial trials for new technologies.

PPPs offer great promise for sustainable development, but they can be extremely complex to design. Among the myriad of challenges that must be tackled in designing effective PPPs are:

**Cost-effectiveness.** In many instances, private companies have proven to be more efficient and cost effective in delivering investments than public entities, but this is not always the case. In particular, networked infrastructure and other “natural monopolies” can give rise to predatory pricing by private entities, which reduce the attractiveness of PPPs.

**An efficient level of overall investment.** Only public (co-)financing can ensure an efficient level of public good provision. The more a PPP requires the private entities to provide co-financing for capital or operating expenditure, the bigger the risk that the overall level of investment is too low. Achieving the efficient level of overall investment without squandering scarce public resources requires highly sophisticated service contracts and a careful calibration of incentives.

**Equity in financing and service delivery.** Private companies maximize profits and therefore have an incentive to reduce the level of service or infrastructure provision to “loss-making” customers. For example, private utilities may generate financial losses on poor or remote customers. Unless effectively regulated, PPPs can reduce equity in financing and service delivery.

**Competition and non-capture by incumbent companies.** Many PPPs give rise to natural monopolies, so PPP design must ensure effective competition in the awarding of contracts and management of the PPP. Where this is not possible, effective regulation must ensure that incumbent companies and public officials cannot capture excessive rents.

**Transparency and non-corruption.** PPPs must be transparent and include sophisticated safeguards to minimize the risk of corruption by public officials and private employees.

This list underscores the “principal agent” problems that PPPs can generate and the complexity that effective design, monitoring and policing may require. Particularly in the poorest countries public institutions may not be strong enough to design and implement effective PPPs. Consequently, the “transaction costs” of PPPs and the ability of a country to manage the PPP must be carefully weighed against the benefits it is intended to generate.

### **The role and limits of remittances**

Remittances are private flows of financing, usually within families, that may support investments (e.g. in small enterprises, housing) or consumption expenditure of poor households (e.g. payment for food, school fees, or medical expenses). They can be an important income source for poor households, but they do not finance public goods nor transfer incomes from rich households to poor households. Increasing the ability of the poor to earn income by working in richer countries is double edged. It might provide more income for poor families on a market basis, but it can contribute to brain drain and the loss of family cohesion as well, as children grow up without the presence of one or both parents. For these reasons, remittances may be important but should not be confused with public financing.

## **II. What is Wrong with Today’s Development and Climate Finance?**

Financing for development and climate change is deficient for several reasons. First, the scale of public financing is chronically insufficient. Only five high-income countries have met the forty-year-plus commitment to provide at least 0.7% of GNI in official development assistance (ODA) (Denmark, Luxemburg, Netherlands, Norway, Sweden). The United Kingdom is on track to meeting this important target, but many other countries have abandoned their own recent pledges to reach this threshold. The experience with fledgling climate finance points in a similar direction. Rich countries are not on track to meeting the climate finance commitments they have made at the 2009 and 2010 COPs in Copenhagen and Cancùn. Many other high-income countries are not members of the OECD DAC and have yet to make any firm pledges to increase their contribution to international development and climate finance (Annex 1). We will return to the 0.7% target and the responsibilities of all high-income countries below.

Second, the distinction between public and private financing is often poorly understood and muddled. All too often private finance is deemed to be a substitute for public financing of public goods or extreme poverty reduction. For example, some commentators have suggested that the \$100 billion in climate finance promised at the 2010 COP in Cancùn could be provided entirely through private means. As explained above, this is of course impossible since private finance does a poor job at financing the needed public goods and since many of the recipient countries are too poor for private finance. Substantial public

financing is required for development and climate finance. Otherwise the poor will suffer and public goods (particularly for adaptation) will go undersupplied.

Third, in spite of years of work on improving aid effectiveness, the quality of ODA remains inadequate. In particular, aid is not long-term and predictable enough to finance the expansion of public investments in core infrastructure and social services. The effectiveness of aid is further reduced by the large number of donors and donor interfaces recipient countries have to work with, poor donor coordination, a lack of pooled resources, and a reluctance on the part of donors to finance the operating expenditure, which dominate the provision of health and education services. These issues have been well understood for some time, and solutions have been agreed in the 2005 Paris Declaration on Aid effectiveness, the 2008 Accra Agenda for Action, and the 2011 Busan Partnership for Effective Development Cooperation. Yet, to date too little progress has been made in improving the efficacy of development and climate finance.

Much South-South Cooperation tends to focus on direct public financing or public guarantees for infrastructure investments. Some of it comes in the form for “triangular cooperation,” in which an international agency or a “northern” donor supports South-South cooperation. South-South infrastructure financing is making a notable difference to filling the infrastructure gap in Africa and elsewhere, especially the infrastructure financing by China. Much less South-South Cooperation is directed to the financing of other public goods, such as social services and environmental protection. While limited reporting on South-South Cooperation makes it difficult to assess its contribution towards meeting the public financing deficit in developing countries, the limited scale and scope of South-South Cooperation cannot make up for the deficiencies and lack of aid from the traditional OECD DAC members and other high-income countries.

### **III. A Framework for Post-2015 Development and Climate Finance**

Overcoming the deficiencies of today’s official development assistance and climate finance will require a clear framework for post-2015 development aid and climate finance. This framework will need to address many complex questions, such as: How much financing is required? Which countries should receive public financing and how can countries graduate from development assistance? How should global public goods be financed? How will public development and climate finance be mobilized and how should it be disbursed to ensure maximum impact? Finally, how can funds be used efficiently by maximizing the leverage of scarce public resources through private means, increasing the predictability of aid and lowering transaction costs?

#### **The central importance of domestic resource mobilization**

Countries have the primary responsibility for financing their own development. Under a post-2015 framework there can be no “right” to international public financing for development and climate finance unless a country is also mobilizing domestic resources within its means. Fortunately as IMF analyses document, virtually all low-income countries have made tremendous strides in increasing domestic resource mobilization as a share of gross national income. This trend should continue further, and it should be underpinned by clear standards and expectations for ODA and climate finance.

Moreover, rich countries should help poorer countries mobilize domestic resources. In particular, they should take the lead in closing tax havens and anonymity havens that serve as magnets for tax evasion and capital flight from poor countries. This is important in enabling countries to raise domestic revenues, particularly from business, without suffering massive evasion.

#### **How much international financing might be required?**

Estimates of international public financing needs for development and climate finance are fraught with difficulties and uncertainties. Many estimates for the financing needs for achieving the MDGs have concluded that public international financing in the order of 0.7% of rich countries' GNI was needed during a limited period of time.<sup>2</sup> Country-level IMF analyses have since shown that external finance flows of this order of magnitude are not only necessary but can be utilized effectively even in very poor countries.<sup>3</sup>

In recent years domestic resource mobilization in low-income countries has increased significantly and the overall GNI of rich countries has grown, including through the graduation of upper-middle income countries into the high-income category. Moreover, extreme poverty in many parts of the world has continued to fall drastically. A robust post-2015 development agenda, backed by timely ODA, would further accelerate the reduction of extreme poverty, ensure rapid convergence in income levels across countries, and thereby help reduce official development assistance needs to a much lower share of rich countries' GNI by 2030. For these reasons, the 0.7% target should be transitional. It might be possible to gradually phase it out during 2020-2025, if it is truly honored until then.

We can summarize as follows. ODA is still needed, and the 0.7% target is still relevant. But the purpose of ODA should be to put itself out of business during the next 15-year period – with the exception of ongoing financing for global public goods. Poor countries should graduate from aid, and ODA should be scaled down as that happens. Yet success in development depends on timely ODA now. If ODA is insufficient, development will not succeed in many impoverished countries, and the intense frustration of inadequate aid combined with inadequate economic progress will continue. It will be like a patient that never recovers because the doctor is always providing a sub-therapeutic dose of medicine.

In addition to the international ODA needs must be added the substantial public financing needs for climate finance, R&D, biodiversity conservation, and other public goods other than the end of extreme poverty. Estimates vary widely and are subject to great uncertainty, e.g. with regards to future climate impacts, the pace at which greenhouse gas emissions will be reduced, the cost curve for mitigation efforts, and measures needed for climate change adaptation. Our reading of available estimates<sup>4</sup> suggests that the \$100bn in international climate finance promised at the 2010 COP in Cancun will be required and that much of this financing will need to come in the form of grants.

### **Eligibility and Graduation Criteria**

Public development and climate finance is scarce. To ensure efficient deployment, eligibility for ODA and climate finance should be determined as a function of a country's ability to self-finance the necessary public investments. Since both domestic resource mobilization and countries' ability to raise funding from private sources are a function of per capita incomes, the latter should form the basis for determining eligibility and graduation criteria. A shorthand form of grouping countries by their ability to pay is the World Bank classification of GDP per capita expressed in 2012 income scale in purchasing-power parity (Annex 1):

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<sup>2</sup> See for example, MDG Africa Steering Group (2008) *Achieving the MDGs in Africa. Recommendations by the MDG Africa Steering Group*; Bourguignon F, Diaz-Bonilla, C, Lofgren H. (2008) *Aid, Service Delivery, and the Millennium Development Goals in an Economy-Wide Framework*. World Bank; Millennium Project (2005) *Investing in Development*, Commission for Africa (2005) *Our Common Interest*.

<sup>3</sup> See for example, IMF (2008) *The Macroeconomics of Scaling-up Aid: The Cases of Benin, Niger and Togo*.

<sup>4</sup> See for example, Stern, N. (2009). *The Global Deal. Climate Change and the Creation of a New Era of Progress and Prosperity*. Public Affairs. New York. For a detailed discussion of methodological issues and an estimate for Africa, see Fankhauser S, Schmidt-Traub G (2011) *From Adaptation to Climate-Resilient Development. The cost of climate-proofing the Millennium Development Goals in Africa*. *Climate and Development*. Volume 3, Issue 2, 2011

- High-income country (>\$12,476)
- Upper-middle-income country (\$4,036-\$12,475)
- Lower-middle-income country (\$1,026-\$4,035)
- Low-income country (<\$1,025)

These country groupings could plausibly form the basis for eligibility and graduation criteria. Before outlining how these eligibility and graduation criteria might work, a few caveats are in order: First, we underscore the preliminary nature of this proposal and the need for a thorough debate on how it might be improved further. Second, while we believe that clear and transparent eligibility and graduation criteria are important, we recognize the need for flexibility to respond to exceptional circumstances. Third, this proposal focuses on public financing for development and climate finance. A strong case can be made to continue technical cooperation with countries that no longer qualify for ODA funding for investments in development. Finally, and perhaps most importantly, these criteria do not imply an automatic provision of ODA and public development finance. Where private finance can replace public funding (e.g. for an infrastructure project in an LIC), the former should usually take precedence. Likewise, recipient countries need to mobilize domestic resources and demonstrate that they can use incremental ODA and climate finance effectively.

With these caveats in mind, here is how the eligibility and graduation criteria might work: High-income and upper-middle-income countries have the means to finance the public investments needed for poverty alleviation. Both country groups can also provide ODA to other countries with high-income countries naturally bearing a higher share of their own income. The ODA collected from these countries should be targeted entirely to low-income countries. Of course low-income countries must make sufficient efforts to mobilize their own domestic resources, and most of them have done so over the recent decade, as evidenced by numerous IMF publications.

Lower-middle-income countries should neither contribute to nor receive ODA in the form of grants. As soon as a country reaches lower-middle-income status it should automatically “graduate” from ODA since it now has the means to finance the needed public investments domestically. Lower-middle-income countries should, however, remain eligible for market-based loans from the international financial institutions (IFIs), including the World Bank and the Regional Development Banks (RDBs). The interest rates on these loans are equal to the borrowing rates of the high-income members of these institutions. In effect, the lower-middle income members are receiving a partial subsidy, not in the form of grant financing, but in the form of borrowing at a near-risk-free market interest rate. Moreover, such financing can be accompanied by export and investments guarantees by national and international entities, which make it much easier for private companies to invest abroad.

The same logic should apply to eligibility criteria for public climate finance. Low-income countries will require substantial grant and concessional loan support both for adaptation measures and investments in mitigating greenhouse gas emissions. Lower-middle-income countries will be eligible for market-based climate loans and multilateral export/investment guarantees on the standard terms offered by multilateral development banks (MDBs). Since high-income and upper-middle-income countries account for the vast majority of global greenhouse gas emissions they should also mobilize the bulk of climate finance (see Annex 2).

### **The role of private philanthropy**

Private philanthropy has been playing a vital role in development finance for decades. For example the Rockefeller Foundation was a central actor in developing the improved seed varieties and farming



techniques that drove the green revolution in the 1960s and 1970s. More recently and in large measure through the pioneering work of the Gates Foundation, private philanthropy has also been making major contributions towards providing core operating budgets to programs in health or agriculture. Together with many other prominent philanthropists like George Soros they have helped make the international development finance system more results-oriented.

The unprecedented rise in private wealth is creating opportunities to drastically increase the contribution of private philanthropy towards financing international development and the response to climate change. Recently, the Giving Pledge created by Bill Gates and Warren Buffett reached a critical milestone of signing up commitments by individuals to donate at least half of their collective wealth of some \$500bn to philanthropic causes. Assuming that perhaps half of that funding might contribute towards public development and climate finance, an endowment model at 5% per annum would yield annual flows of \$6.25 billion. If this model were applied to the full 2012 Forbes list of some 1,226 billionaires and their estimated cumulative wealth of \$4.6 trillion, it might yield annual flows of some \$57 billion. Such financial flows could make a very substantial contribution to the public financing for development and climate finance.

#### **IV. Disbursing Climate and Development Finance more effectively**

ODA and climate finance must be disbursed effectively, but many recipient countries still need to deal with dozens of donors in sectors like health or education. A similarly bewildering array of bilateral and multilateral programs is emerging for climate finance. This makes it impossible to operate effectively and use scarce funds for maximum benefit. Such inefficiencies also weaken the case for ODA and public climate finance in high-income countries. Unless addressed they may undermine the feasibility and legitimacy of a bold post-2015 development agenda.

The situation has improved slightly in recent years with the emergence of pooled disbursement arrangement between a handful of bilateral donors. Yet, these improvements are marginal. A post-2015 framework needs to reduce drastically the number of interfaces that recipient countries and their ministries have to deal with. A reformed aid agenda, following the principles of the Paris/Accra/Busan agendas, should ensure much greater pooling of donor resources to achieve the following:

1. **Country-led programs & national ownership:** Funding must be provided on the basis of country-led programs developed by the responsible line ministries. Such country leadership and ownership cannot be mobilized through a series of poorly coordinated small-scale programs.<sup>5</sup> Experience in the health sector and elsewhere shows that when countries can apply for large-scale pooled funding, the responsible line ministry becomes a potential source for significant volumes of predictable funding. This in turn has been shown to mobilize unprecedented efforts on behalf of governments to ensure the success of these programs.
2. **Low transaction costs & minimal duplication:** By reducing the number of interfaces, reporting requirements, and financial flows, pooled mechanisms can drastically reduce

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<sup>5</sup> Take the example of the health sector where it is common for some African countries to deal with over 30 donors (excluding NGOs and foundations). Each of these donors has its own requirements for the use of funds, disbursement schedules and conditions, reporting requirements. In some extreme cases, part of the aid remains tied and/or must go through separate vertical programs outside the control of the national health system. In such a context African ministers of health and finance spend an inordinate amount of time negotiating and dealing with the representatives of multilateral and bilateral programs. It becomes virtually impossible to have a true national program, and “national ownership” becomes a rhetorical commitment that is impossible to materialize. A global health fund would cut the bilateral interfaces to one in each country and allow country officials to focus on the important tasks of designing, implementing and monitoring their national health strategy.

transaction costs on donor and recipient sides. Likewise, it becomes much easier to avoid redundancies and overlaps in the international development and climate finance architecture once the bulk of financing flows through a small number of global funds, regional programs or other large-scale pooling mechanisms.<sup>6</sup>

3. **Technical integrity and efficient knowledge transfer:** Funding programs of significant scale can develop robust systems to ensure independent high-quality technical appraisals of funding proposals, monitoring and evaluation. They also provide effective forums for knowledge transfer across countries. For example, while FTI/EFA has been less successful in mobilizing the required financing for the education sector, it has had a tremendous impact in consolidating best practice for national programs to achieve universal primary education, and in defining the core parameter, such as student-teacher ratios, that drive successful programs. In this way, the initiative has had a disproportionate effect on improving the quality and efficacy of national education strategies.
4. **PPP windows & clear interface with the private financiers:** Another important advantage of large pooling mechanisms lies in their ability to define PPP windows and blending mechanisms for public and private financing. Instead of having to negotiate with a large number of bilateral donor agencies, private investors would deal with fewer pooling mechanisms. This in turn will increase competition and lower the cost of private blending. Since the opportunities and effective operational modalities for blending public and private financing vary across sectors, it makes sense to structure blending mechanisms on sectoral lines (e.g. infrastructure) to facilitate private leveraging of public funds. This approach has been impressively demonstrated by GAVI's success in developing a number of scalable specialized public-private co-financing vehicles for specific health financing needs.
5. **Transparent financing parameters:** Financing of global funds and other large pooling mechanisms can be guaranteed on the basis of clear country-by-country assessments, using per capita income levels and total national income as guidelines (as with IMF and World Bank quotas, and UN assessed dues).

The principle of pooled disbursement has been widely recognized by DAC members, but far too little progress has been made towards its realization. Taken to its logical conclusion, the principle implies that ODA and climate finance would be disbursed through a small number of "global funds" that pool donor money and that provide multi-year financing arrangements in critical areas. Such a system would not spell the end of bilateral cooperation, which should focus on high-quality technical cooperation and smaller volumes of bilateral financing, but it would represent a major and salutary change in the way development cooperation works.

Several such global funds pooling mechanisms exist. Each has continued to evolve and improve its operations over time. To the extent possible, ODA and climate finance should be mainly channeled through these mechanisms:

- **Infrastructure.** *The World Bank and the Regional Development Banks* should have the lead in financing infrastructure through their existing windows including the World Bank's IDA. As

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<sup>6</sup> It is sometimes argued that pooling mechanisms, such as global funds, would add another layer of complexity, which is of course not the case. Instead global funds and other pooling mechanisms remove the inordinate number of bilateral financing negotiations and interfaces that currently occur in every country. Where effective pooling mechanisms already exists, the efficiency gains can be immediate. For example, in the health sector virtually every bilateral and multilateral donor already works with the GFATM, so broadening the fund's mandate would lead to a drastic reduction in transaction costs.

described below, the new Green Climate Fund should provide co-financing for low-carbon infrastructure and climate-proofing infrastructure.

- **Health.** The GFATM and GAVI are both very successful. They can give rise to a single *Global Health Fund* to ensure universal access to primary health care.
- **Education.** The existing Global Partnership for Education (formerly Education for All) remains under-provisioned and applies only to primary education. It could evolve into a new *Global Education Fund* that would support low-income countries to meet the challenge of ensuring universal access to quality primary and secondary education.
- **Agriculture/nutrition.** The Global Agriculture and Food Security Program, WFP and IFAD can form the backbone for the much-needed scaling up of investments in sustainable agriculture and nutrition.
- **Biodiversity.** The *Global Environment Facility* should be expanded to be the world's preeminent funding mechanism for global biodiversity conservation.
- **Climate Change.** The *Green Climate Fund* has been established to provide adaptation and mitigation financing for low-income countries. Since many adaptation and some mitigation measures are "development interventions" (e.g. better water management, climate-resistant infrastructure, control of vector-borne diseases) the Green Climate Fund should channel much of its financing through specialized sector funds. A model for financing the Green Climate Fund is provided in an annex to this paper.

In other critical areas new global pooling mechanisms are needed:

- **Technology Development.** A new financing architecture is needed to make good on long-standing promises of technology transfer in the arena of sustainability. A new global fund to support R&D and early-stage diffusion of sustainable technologies (e.g. renewable energy, carbon-capture and sequestration) should be implemented. This fund could also help to defray the royalty charges facing poor countries on sustainable technologies held by private-sector patent holders.
- **Peace-building.** A new *Peace-building Fund*, operating as a joint venture of the IFIs and UN agencies under the auspices of the Peacebuilding Commission, could meet the needs of early-stage recovery from conflict in low-income settings. This could be financed through a small assessment (overhead) on all peacekeeping operations.

In addition to financing national or sub-national programs, each global fund needs to have a dedicated financing window to support R&D and the development and deployment of pre-commercial technologies financing. These windows would also support the diffusion of technologies, particularly to low-income countries.

In practice there will be some overlap between global funds other pooling mechanisms and bilateral assistance. Most obviously, the scope of the Green Climate Fund will overlap with that of every other mechanism. Likewise, the World Bank's IDA plays an important role in mobilizing financing for IDA-eligible low-income countries. Such overlaps across financing mechanisms can be managed through pass-through arrangements and standardized co-investment agreements across funds in particular sectors.

Clearly, this architecture would mark a major departure from current practice, and it would undoubtedly be controversial with some donor agencies. Yet, there can be no doubt that the current system for development and climate finance is not up to the task of supporting a post-2015 development agenda and that progress in reforming it has been too slow. The growing pressure on public finances, particularly in high-income countries, makes it imperative to develop a more efficient architecture that minimizes transaction costs, enhances transparency, and effectively applies lessons learnt in one setting to others. It is difficult to see how these objectives could be achieved without channeling the bulk of public financing through pooled disbursement mechanisms, such as global funds.

## V. The politics of international development and climate finance

All countries and actors will need to contribute to a financing framework that can meet the challenges of a post-2015 agenda for poverty eradication and sustainable development. This will require compromise and concessions from all parties. This paper outlines a financing arrangement in which every stakeholder compromises to achieve an acceptable outcome for everyone. It includes:

- **High-income countries (DAC members)** need to honor the financing commitments they have made in the past and ensure that high-quality ODA goes to the neediest countries with maximum efficiency and minimal transaction costs. As this paper argues this will require more ODA over the short- to medium-term and much greater use of pooled disbursement mechanisms, which tend to be unpopular among bilateral agencies.
- **Non-DAC high-income countries** should have essentially the same obligations with regards to providing adequate and high-quality climate and development finance as DAC members

**Middle-income countries** are asked to play a new role. Upper middle-income countries (UMICs) will themselves become aid donors rather than recipients, albeit on a smaller scale than the high-income countries. Lower-middle-income countries (LMICs) will generally be neither grant recipients nor donors, but they will receive risk guarantees and other forms of financial support. The LMICs should also contribute a small amount to climate financing in relation to their greenhouse gas emissions.

- **Low-income countries** need to strengthen domestic resource mobilization and should accept accountability for the effective use of resources.
- **Multi- and bi-lateral donor agencies** need to focus their financing towards the low-income countries, with a special emphasis on the poorest countries. For example, they need not provide grant support to middle-income countries still battling to end pockets of extreme poverty. The host countries can take on this challenge largely or fully themselves.
- **Business** has an important role to play in leveraging public resources, but its contribution must not lead to excessive transaction costs or simply offload risks to public financing agencies.

As this list makes clear, a viable financing framework for the post-2015 agenda will require compromises from everyone. In some cases these compromises may face domestic or institutional resistance. Yet, such shared problem solving is required in an interconnected world where some challenges can only be met through international cooperation and official financing. In the end an effective system for official development and climate finance will make everyone better off.

## **VI. Considerations for the High-Level Panel and the Post-2015 Development Agenda**

The importance of financing for the post-2015 development agenda cannot be overstated. Marginal changes to the current systems for development and climate finance will not suffice for a viable post-2015 agenda. The HLP has a unique opportunity and mandate to put forward practical ideas for organizing a rational development finance framework. In summary, we propose the following items for consideration by the panel:

- 1. The importance of ODA and public development finance:**
  - a. The need for the 0.7% target to be continued during the coming years, though eventually phased out as countries graduate from low-income status.**
  - b. The importance of new ODA providers among high-income and upper-middle-income countries that are not part of the OECD DAC.**
- 2. The importance of public co-financing of climate-change mitigation and adaptation in low-income countries.**
- 3. The need for clear eligibility and graduation criteria for public development and climate finance in a world of scarce resources. Such eligibility criteria should be based on countries' ability to self-finance the necessary public investments and to contribute towards the financing of global public goods. Income per capita remains the best single standard for judging capacity to pay.**
- 4. The need for transparent pooling mechanisms such as global funds that operate on the basis of evidence-based and country-led programs, disburse scarce public funding effectively, leverage private-sector resources where possible, and ensure maximum learning from countries' experiences.**

## Annex 1. Countries by World Bank Income Category (2012 data)

High income		Upper middle income		Lower middle income		Low income
Andorra	Korea, Rep. *	Angola	Palau	Albania	Samoa	Afghanistan
Aruba	Kuwait	Algeria	Panama	Armenia	São Tomé and Príncipe	Bangladesh
Australia*	Liechtenstein	American Samoa	Peru	Belize	Senegal	Benin
Austria*	Luxembourg **	Antigua and Barbuda	Romania	Bhutan	Solomon Islands	Burkina Faso
Bahamas, The	Macao SAR, China	Argentina	Russian Federation	Bolivia	South Sudan	Burundi
Bahrain	Malta	Azerbaijan	Serbia	Cameroon	Sri Lanka	Cambodia
Barbados	Monaco	Belarus	Seychelles	Cape Verde	Sudan	Central African Republic
Belgium *	Netherlands **	Bosnia and Herzegovina	South Africa	Congo, Rep.	Swaziland	Chad
Bermuda	New Caledonia	Botswana	St. Lucia	Côte d'Ivoire	Syrian Arab Republic	Comoros
Brunei Darussalam	New Zealand *	Brazil	St. Vincent and Grenadines	Djibouti	Timor-Leste	Congo, Dem. Rep
Canada *	Northern Mariana Islands	Bulgaria	Suriname	Egypt, Arab Rep.	Tonga	Eritrea
Cayman Islands	Norway **	Chile	Thailand	El Salvador	Ukraine	Ethiopia
Channel Islands	Oman	China	Tunisia	Fiji	Uzbekistan	Gambia, The
Croatia	Poland	Colombia	Turkey	Georgia	Vanuatu	Guinea
Curaçao	Portugal *	Costa Rica	Turkmenistan	Ghana	Vietnam	Guinea-Bissau
Cyprus	Puerto Rico	Cuba	Tuvalu	Guatemala	West Bank and Gaza	Haiti
Czech Republic	Qatar	Dominica	Uruguay	Guyana	Yemen, Rep.	Kenya
Denmark **	San Marino	Dominican Republic	Venezuela, RB	Honduras	Zambia	Korea, Dem Rep.
Estonia	Saudi Arabia	Ecuador		Indonesia		Kyrgyz Republic
Equatorial Guinea	Singapore	Gabon		India		Liberia
Faeroe Islands	Sint Maarten	Grenada		Iraq		Madagascar
Finland *	Slovak Republic	Iran, Islamic Rep.		Kiribati		Malawi
France *	Slovenia	Jamaica		Kosovo		Mali
French Polynesia	Spain *	Jordan		Lao PDR		<b>Mauritania</b>
Germany *	St. Kitts and Nevis	Kazakhstan		Lesotho		Mozambique
Greece *	St. Martin	Latvia		Marshall Islands		Myanmar
Greenland	Sweden **	Lebanon		Micronesia, Fed. Sts.		Nepal
Guam	Switzerland *	Libya		Moldova		Niger
Hong Kong SAR, China	Trinidad and Tobago	Lithuania		Mongolia		Rwanda
Hungary	Turks and Caicos Islands	Macedonia, FYR		Morocco		Sierra Leone
Iceland	United Arab Emirates	Malaysia		Nicaragua		Somalia
Ireland *	United Kingdom *	Maldives		Nigeria		Tajikistan
Isle of Man	United States *	Mauritius		Pakistan		Tanzania
Israel	Virgin Islands (U.S.)	Mexico		Papua New Guinea		Togo
Italy *		Montenegro		Paraguay		Uganda
Japan *		Namibia		Philippines		Zimbabwe

\* Denotes member of the OECD DAC

\*\* Denotes OECD DAC member that provides at least 0.7% of GNI in ODA

## Annex 2. Financing the Green Climate Fund Through Assessed Contributions

Financing for global public goods in the area of climate change should be provided through the Global Green Climate Fund or similar mechanisms based on assessed contributions as outlined below. Such financing may include performance-based payment for the protection of tropical rainforests, public co-financing for the development of emission reduction technologies and efforts to share the benefits of these technologies as widely as possible.

We suggest a financing model for the Green Climate Fund based on a country's per capita level of income and its greenhouse gas emissions. The combination of these two criteria will help ensure that all countries contribute towards climate change mitigation and adaptation based on their ability to pay and their contributions towards global emissions. Financing would be determined through annual "assessed contributions" using the following formula:

$$\text{Assessed climate finance contribution} = \text{GDP Factor} \times \text{CO}_2 \text{ Emissions} \times \text{CO}_2 \text{ Assessment Rate}$$

The *GDP Factor* (as of 2012) would be as follows:

- High-income country (>\$12,476): 1.0
- High Middle-income country (\$4,036-\$12,475): 0.5
- Low Middle-income country (\$1,026-\$4,035): 0.25
- Low-income country (<\$1,025): 0.0

The *Assessment Rate* is expressed in \$US/ton of CO<sub>2</sub>. If one assumes for illustration that some \$100 billion would need to be raised every year in public financing, then the appropriate level of assessment is \$5 per ton of CO<sub>2</sub> emission at today's levels of greenhouse gas emissions. Below we illustrate resource mobilization for an assessment rate of \$5 per ton, based on energy-based CO<sub>2</sub> emissions in 2010. We distinguish between production and consumption-based estimates of CO<sub>2</sub> emissions. The former describe the total emissions in a country, while the latter assign greenhouse gas emissions related to the export and import of products to the country where the goods are consumed. Consumption-based estimates probably provide a truer picture of a country's carbon footprint, since what matters is the volume of greenhouse gases that are "consumed" and not where these emissions occur.

As explained in the text, we distinguish for illustrative purposes between production and consumption-based estimates of GHG emissions. For both we present the latest available data (2011 and 2009, respectively). Consumption-based estimates shift a larger share of the financing responsibilities to countries that import GHG-intensive products. These climate finance assessments would complement official development assistance provided by high-income countries. The assessment rate could be fixed every five years to produce the targeted funding stream. Of course the values of these parameters are illustrative only and can be revised as necessary.

Country	Income Category	GDP Factor	Illustrative Assessment Rate (\$/tCO <sub>2</sub> e)	Production-based estimate of GHG emissions				Consumption-based estimate of GHG emissions			
				Energy-related GHG emissions 2011 (GtCO <sub>2</sub> e/year)*	Energy-related GHG emissions 2011 (tCO <sub>2</sub> /capita/year)	Assessment (\$ billion)	Assessment (% GDP PPP)	Energy-related GHG emissions 2009 (GtCO <sub>2</sub> e/year)**	Energy-related GHG emissions 2009 (tCO <sub>2</sub> /capita/year)	Assessment (\$ billion)	Assessment (% GDP PPP)
Brazil	Upper middle income	0.50	5.00	0.450	2.3	1.1	0.05%	0.3762	1.95	0.9	0.05%
Cambodia	Low income	0.00	5.00	0.001	0.1	0.0	0.00%	n/a			
China	Upper middle income	0.50	5.00	9.700	7.2	24.3	0.21%	5.1878	3.90	13.0	0.14%
India	Lower middle income	0.25	5.00	1.970	1.6	2.5	0.06%	1.5637	1.29	2.0	0.05%
Indonesia	Lower middle income	0.25	5.00	0.490	2.0	0.6	0.05%	0.3865	1.63	0.5	0.05%
Liberia	Low income	0.00	5.00	0.001	0.1	0.0	0.00%	n/a			
France	High income	1.00	5.00	0.360	5.5	1.8	0.08%	0.5565	8.60	2.8	0.13%
Japan	High income	1.00	5.00	1.240	9.7	6.2	0.14%	1.2914	10.12	6.5	0.16%
Mexico	Upper middle income	0.50	5.00	0.450	3.9	1.1	0.07%	0.4476	4.00	1.1	0.08%
Mozambique	Low income	0.00	5.00	0.004	0.2	0.0	0.00%	n/a			
United Kingdom	High income	1.00	5.00	0.470	7.5	2.4	0.10%	0.6722	10.88	3.4	0.16%
United States	High income	1.00	5.00	5.420	17.4	27.1	0.18%	5.6996	18.58	28.5	0.20%

\*Source: Emissions Database for Global Atmospheric Research. Available at <http://edgar.jrc.ec.europa.eu/overview.php?v=CO2ts1990-2011>

\*\*Source: Boitier B (2012) CO<sub>2</sub> emissions production-based accounting vs consumption: Insights from the WIOD databases. Available at [http://www.wiod.org/conferences/groningen/paper\\_Boitier.pdf](http://www.wiod.org/conferences/groningen/paper_Boitier.pdf).

**Table: Illustrative calculation of assessments for climate finance based on countries' production and consumption-based emissions of GHG and their p.c. GDP.**