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COST OF CAPITAL AND THE ENERGY TRANSITION

Foundations Platform F20

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Matt Robinson and **Lucie Villa**, Moody's
Alexander Jacobs and **Sina Sinai**, Jain Family Institute
Michael Hughman, Children's Investment Fund Foundation

1 COST OF CAPITAL AND THE ENERGY TRANSITION

1.1. INTRODUCTION - COST OF CAPITAL AS A BARRIER TO ENERGY TRANSITIONS IN LMICS

While global investment in the energy transition has grown rapidly in recent years, from $1.2 trillion in 2021 to $2.1 trillion in 2024 (Bloomberg, 2025), the share of this investment reaching low- and middle-income countries (LMICs) remains small, at around 14% in 2023[1] (IRENA, 2024). Though African countries are home to 40% of the world's potential for solar energy, just $40 billion was invested in energy transitions on the continent in 2024; in the same year, investment in fossil fuels in the region amounted to $70 billion (Hill, 2025; IEA, 2024b).

LMICs urgently need more investment in energy transitions to prevent fossil fuel lock-in, to meet the goals in their Nationally Determined Contributions (NDCs) under the Paris Agreement on Climate Change and achieve Sustainable Development Goal (SDG) 7: "affordable, reliable, sustainable and modern energy for all" by 2030 (Koefoed & Selvakkumaran, 2025). The 2025 Tracking SDG 7: Energy Progress Report states that the "[l]ack of sufficient and affordable financing remains one of the key reasons for the slow, uneven progress in achieving SDG 7" (IEA/IRENA/WB, 2025).

The International Energy Agency estimates that in LMICs, annual investment in the energy transition needs to increase from $270 billion today to $870 billion by the early 2030s to meet national climate and energy pledges, and $1.6 trillion to get on track for a 1.5°C pathway (IEA, 2024). This investment is needed not just to expand renewable energy generation capacity, but also, among other things, to modernise and strengthen grid infrastructure and to electrify and decarbonise heat, industry and transport (IEA, 2023 & 2024).

This paper investigates the impacts of high cost of capital and debt burdens on the energy transition in LMICs, with a special focus on Africa. It then highlights different approaches proposed and employed to address these issues and unlock the financing LMICs need to drive just energy transitions.

1 *This is the number for LMICs excluding China.*

1.2.

REDUCING THE COST OF CAPITAL IS ESSENTIAL TO THE ENERGY TRANSITION IN EMERGING MARKET AND DEVELOPING ECONOMIES

The primary reason why renewable energy investments remain costly in African countries and other LMICs, compared to fossil fuels, is the high cost of capital (CoC) these countries face. Renewable energy generation projects require higher upfront costs but have much lower running costs than fossil fuel-based generation. A high CoC raises the cost of that upfront investment; as a result, renewable technologies such as solar and wind remain economically uncompetitive in some LMIC markets, while in countries with lower CoC they are already considerably cheaper than fossil fuels. The weighted average cost of capital (WACC) for energy projects in Africa was estimated at over 18% in 2023, compared to under 5% in Europe and the United States (CCSI, 2025). Financing costs regularly constitute over half of the levelised cost of electricity (LCOE) for utility-scale solar projects in LMICs (see fig. 3; IEA, 2024).

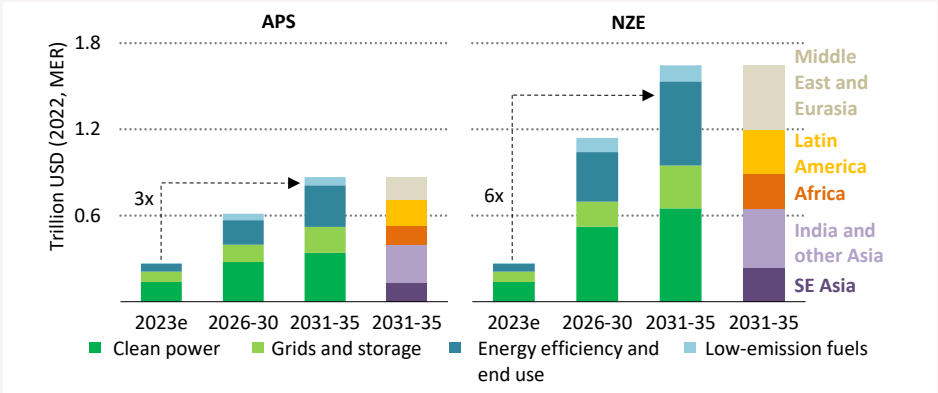


Figure 1.
Clean energy investments in emerging and developing economies (EMDEs) by sector and region in the Announced Pledges Scenario (APS) and the Net Zero Emissions by 2050 (NZE) scenario, source: IEA "Reducing the Cost of Capital", 2024

One of the reasons why LMICs are so exposed to high CoC when attempting to finance the energy transition is the reduction in official development assistance (ODA) and concessional capital available, so that countries are forced to raise financing on the international capital market (Hurley, Wilkinson & Aitken, 2025; UNDP, 2023). In addition, international public finance flows supporting renewables in LMICs are highly concentrated in just a few countries—29 countries accounted for 80% of these flows in 2023 (IEA/IRENA/WB, 2025).

The CoC is a reflection of perceived and actual investment risks, which vary by country and sector. It consists of

1. a base rate, which is the return an investor would expect anywhere in the world, also affected by interest rates set by central banks in high income countries;
2. country-level risks related to political instability, currency risks, etc.
3. and a sector or technology premium - for the energy sector, these include off-taker risk, risks related to transmission network reliability, supply chain risks, risks related to the regulatory environment, etc.; (IEA/IRENA/WB, 2025; Stedile & Gordon, 2025).

In African countries, country-level risks account for 60-90% of overall WACC for solar PV, compared to 35% in China and 10% in high-income countries (HIC; Stedile & Gordon, 2025). It is important to note that the WACC is an average that is brought down by the inclusion of concessional financing and does not reflect capital market borrowing costs; for example, due to the availability of concessional finance, the overall WACC in Kenya and Senegal is around 9%, but businesses raising capital in these countries face borrowing costs over 15%, as well as tenures that are too short to be feasible for infrastructure projects (Fang et al., 2025; Stedile & Gordon, 2025).

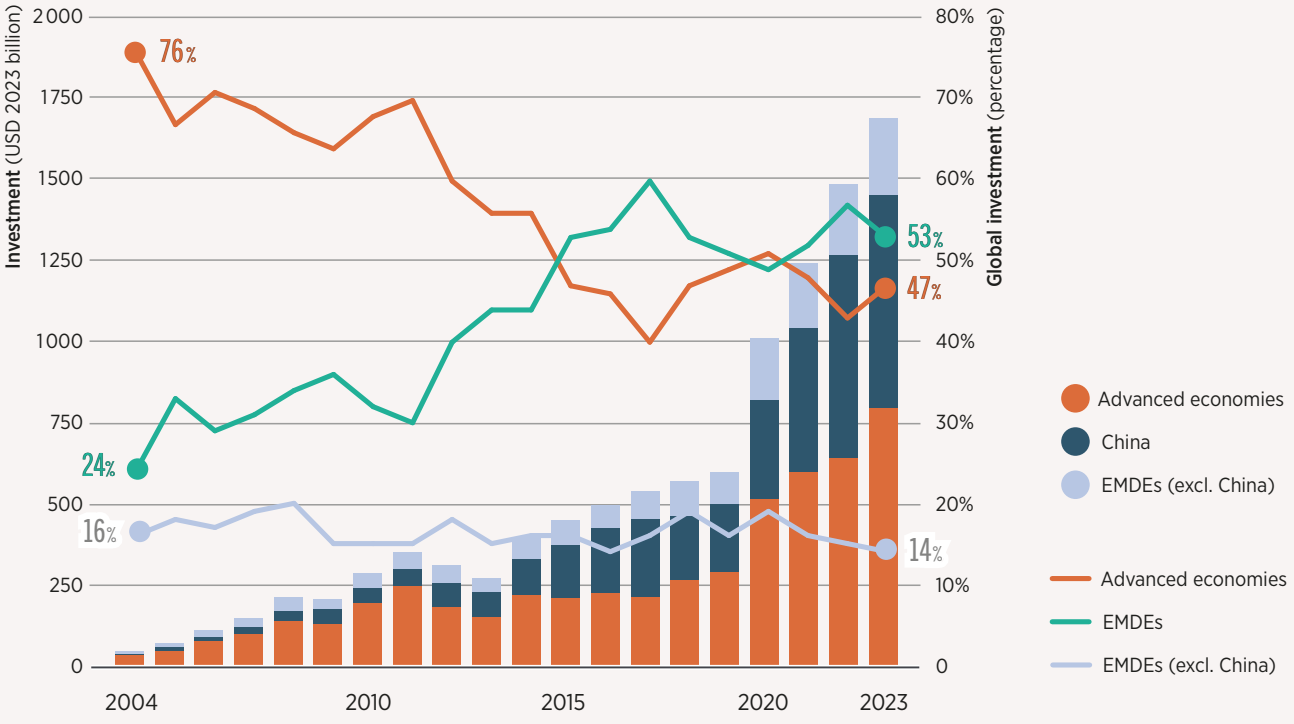


Figure 2. Energy transition-related investments in advanced economies and emerging and developing economies, based on BNEF, 2024a., source: IEA (2025)

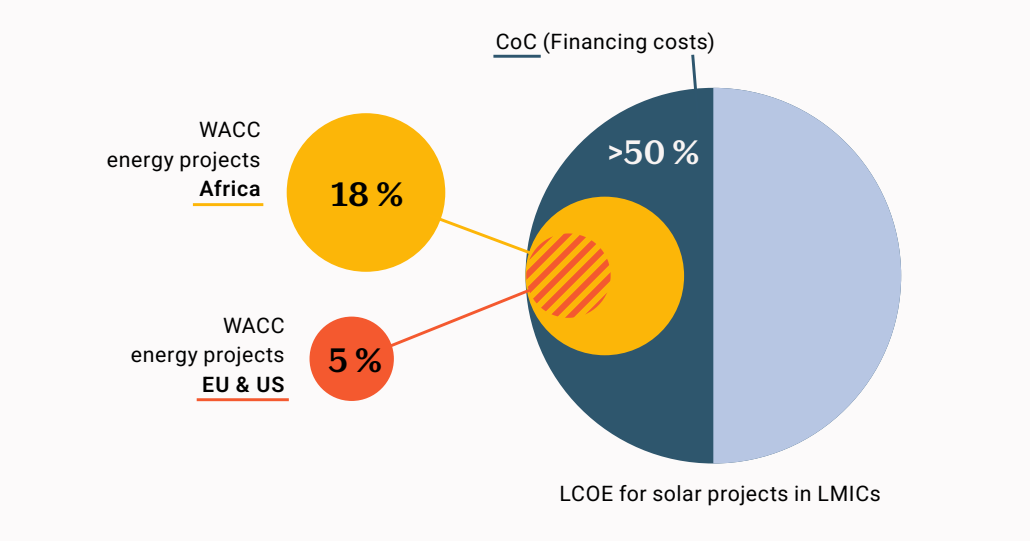


Figure 3, data source: IEA (2024)

While the deployment of mature technologies with tested business models, such as utility-scale solar PV, is already heavily constrained by CoC, investment in innovative solutions or technologies with less well-established business models is even more difficult. Many LMICs have great potential to become early leaders in the deployment of solutions such as green hydrogen but are hampered by even higher costs of capital for such not yet well-established subsectors (Montague, Raiser & Lee, 2024). Companies providing distributed solutions for energy access also face high barriers to accessing finance; especially for small- and mid-sized (often local) companies, foreign currency financing is difficult to access and risky, whereas local currency financing is unaffordable. Along with customer affordability of products, difficulties accessing finance are the main impediment to these companies' expansion and ultimately to achieving universal energy access. CoC faced by energy access companies makes up on average 14% of the price of a solar kit (WB ESMAP, 2024).

Due to high CoC, the countries with the greatest potential and the greatest need for affordable, reliable, and resilient renewable energy solutions are the least able to invest in them.

Studies have shown that if countries in Sub-Saharan Africa had a CoC similar to that of European countries, their solar PV capacity would grow by 100 GW more between 2024 and 2050 (Koefoed & Selvakkumaran, 2025) and they would be able to reach net-zero emissions 10 years earlier than with current CoC (Ameli et al., 2021).

Debt

High CoC is closely linked to unsustainable debt burdens. According to United Nations Trade and Development (UNCTAD), over half of all people in Africa now live in countries that spend more on servicing external debt than on education or healthcare (Zucker-Marques et al., 2025). This is despite the fact that most African countries do not have excessive debt; their debt-to-GDP ratios are lower than those of most European countries (Trading Economics, 2025). However, the debt they hold is extremely expensive, due to the high CoC, and causes a vicious circle: high debt servicing burdens reduce the public capital available for infrastructure investments,

which forces countries to take on additional expensive debt to drive energy transitions, thereby further increasing debt burdens (Diwan, 2025; Expert Review on Debt, Nature and Climate, 2025).

Debt repayments by LMICs, including in Africa, have long dwarfed the volumes of ODA and climate finance provided to these countries. Since 1982, LMICs have paid an estimated $4.2 trillion in interest alone to creditors in high-income countries (HICs) – far more than all ODA and concessional finance flows in the opposite direction over the same period (Civil Society Calls for..., 2023). While debt servicing burdens have been high for decades, they have shot up even more in recent years; between 2023 and 2024, the median value of debt service as a share of public spending in African countries jumped from 7.19% to 13.55%. This is the result of a combination of factors: significant additional borrowing by LMICs during the COVID-19 pandemic, the sharp increase in Central Bank interest rates in 2023, as well as high inflation (Harcourt, Rivera & Robertson, 2025). Between 2024 and 2030, debt service by African governments will far exceed the continent's climate finance needs (Zucker-Marques et al., 2025).

The global financial architecture that resulted in these debts and in the high CoC is viewed by many stakeholders in LMICs as "as a tool of neocolonial control", facilitating the continued extraction of resources while preventing LMICs from investing in their long-term sustainable development on their own terms (Kaboub & Chiriboga, 2025). To make a just energy transition possible, solutions must be found to both problems: CoC must be reduced, while debt problems must be tackled at the same time (Kenewendo, Njoroge & Dryden, 2024).

1.3. EXACERBATING FACTORS AND VICIOUS CYCLES

Several other factors exacerbate the vicious cycle of high CoC and debt. Currency risk, called by one expert “the most significant deterrent to international investment in African climate solutions” (Hill, 2025), is both a significant contributor to and partially a result of high debt burdens (APRM, 2025). Climate vulnerability is worsened by high CoC, which reduces investment in resilience, and itself worsens CoC, as climate risks are factored into investment decisions.

UN Environment estimates that the effect of climate vulnerability on CoC has cost LMICs $62 billion in the past 10 years, and expects additional interest payments due to this vulnerability to increase to at least $146 billion over the next decade. This increase can be mitigated by interventions that enhance resilience, but only if market participants, including credit rating agencies and investors, recognise and have the expertise to quantify the benefits of those interventions (Expert Review on Debt, Nature and Climate, 2025).

2 HOW CAN WE LOWER THE COST OF CAPITAL FOR THE ENERGY TRANSITION?

As mentioned in the previous section, the high CoC for investments in the energy transition in LMICs is a reflection of real and perceived investment risks. Different actors are involved in assessing these risks, the most influential of which are the credit rating agencies (CRAs), especially the 'Big Three': Standard & Poor's, Moody's and Fitch Group. The assessments they undertake and the credit ratings they issue have enormous influence on the types and costs of financing that governments and businesses are able to access.

Given these facts, there are two main pathways for lowering CoC, employed or promoted by different actors: the first is to challenge or change risk assessments issued by CRAs and others; and the second is to reduce risks. This section outlines the context for these pathways and highlights some promising initiatives. It does not advocate for one or the other; lowering the CoC and addressing debt burdens are highly complex issues, and as many actors as possible should, simultaneously and in coordination, work to tackle different aspects of these problems.

2.1.
CHALLENGING RISK ASSESSMENTS

Credit ratings issued by credit rating agencies have enormous influence on governments' and companies' ability to raise financing. Based on extensive assessments, they predict the likelihood of default or late repayment of a loan to a certain country or company, or of a specific financial instrument, such as a bond. Though CRAs are to some extent transparent about their methodologies, especially about the economic and financial market variables used (GDP per capita, debt to GDP ratio, tax to GDP ratio, etc.), they do not share how they assess more subjective indicators, such as institutional quality and political risk, or how they respond to data gaps. This leaves the CRAs vulnerable to accusations of bias, as independent analyses find time and again that objective indicators and past defaults alone cannot account for the differences in ratings between HICs and LMICs.

A 2023 analysis by the United Nations Development Programme (UNDP) found "idiosyncrasies" or "deviations from macroeconomic fundamentals" in credit ratings that cost a sample of African countries $74.5 billion per year in overpayment for financing and lost lending. This $74.5 billion is 12% more than the total ODA received by all African countries in 2020 (UNDP, 2023). A 2025 UNCTAD report finds that "subjective indicators, judgements, and sentiment play an important role" in informing credit ratings, which creates "significant scope for bias", but also highlights that systemic bias is difficult to prove or separate from biases ingrained in the global financial architecture (UNCTAD, 2025).

Analyses by institutions based in LMICs, particularly in Africa, often use much harsher terms, with one study alleging that credit ratings are heavily influenced by media sentiment and stereotypes, and estimating that "if Egypt [...] were covered as positively as Thailand—a country with a similar risk profile—its bond yields could fall by almost one percentage point, saving the country hundreds of millions of dollars annually" (Mo Ibrahim Foundation, 2025). Another study points out that while the credit ratings of LMICs are heavily affected by political uncertainty, the same is not true for HICs, especially in relation to the energy transition. The author argues that power purchase agreements that span multiple election cycles always carry risks – highlighting examples of changes to feed-in tariffs made by successive governments in Spain and Germany, and the

"long history of stop-go" of renewable energy projects in the United States (Persaud, 2023).

Some studies also criticise CRAs' treatment of objective rating criteria, for example the heavy weighting of GDP per capita or population size. One analysis found no evidence that GDP per capita is a useful predictor of default (Lysenko, 2025). Another pointed out that the heavy weighting of population size means that a small LMIC could never achieve an investment-grade rating, even if they were to get everything else right (CCSI, 2025). Analysts also claim that specific strengths of LMICs, such as high population growth rates, rapidly growing consumer spending, and large potential future growth, are undervalued in CRA methodologies (CCSI, 2025; Mo Ibrahim Foundation, 2025).

EVIDENCE OF OVERESTIMATION OF RISK

Credit ratings are ex ante risk assessments: they inform investors of the likelihood of a future default. Ex-post analyses comparing ratings to actual default rates have found significant overestimation of risk. The Global Emerging Markets Risk Database (GEMs) collects data and insights on over 15,000 loans to companies in LMICs. Analyses of the outcomes of those loans have found that defaults predicted by ratings were two to three times higher than those recorded. It should be noted that the GEMs Database covers loans by multilateral development banks (MDBs) and development finance institutions (DFIs), which have more in-depth local knowledge and provide more project advisory support than the average investor (EIB, 2025; Galizia & Lund, 2024). However, the takeaway remains that on average, LMIC companies "are lower risk than many high-yield corporate borrowers from advanced economies" (Galizia & Lund, 2024). In addition, even when a default occurred (in 3.54% of cases), recovery rates were high – investors were able to recover an average of 72% of their investment (EIB, 2025; Galizia & Lund, 2024). In Sub-Saharan Africa, the average default rate was slightly higher, at 6.05%, but so was the recovery rate, at 78% (EIB, 2025). Globally, investments in energy and utilities showed lower default rates than the average (3.27% and 3.01%; Gregory, 2024). As analyses have pointed out, these results reflect well on the de-risking approaches used by MDBs and DFIs, and on their patience when adverse events occur, "staying the course to resolve non-performing loans rather than taking bigger losses by selling them" (EIB, 2025).

Credit ratings influence sovereign bond pricing both directly and by reducing the bargaining power of LMIC governments. When LMIC governments issue Eurobonds, the rates for these are set by bond syndicates consisting of a lead manager (an investment bank) and an underwriter (a financial institution that purchases the entire bond issue if there is insufficient demand). African governments' Eurobonds are in high demand: in recent years, every bond issue has been at least 2.5 times oversubscribed (Mutize, 2025). However, due to their low credit ratings, which leave them with few other options to raise capital, African governments lack the bargaining power to demand lower rates. As a result, they pay 4% more interest on their bonds than Asian and Latin American governments with similar ratings (APRM, 2025; Guzman, Colodenco & Wiedenbrüg, 2024).

What has happened to African sovereign credit ratings recently?

Currently, only two African countries, Botswana and Mauritius, have an investment-grade credit rating. Thirty African countries have ratings below investment grade ('junk status'), while 22 have no rating at all. African sovereign credit ratings were not always this low – in the mid-2010s,

Côte d'Ivoire, Kenya, Namibia, Senegal and South Africa all had investment-grade ratings (Aninver, 2025). The economic stress caused by the COVID-19 pandemic resulted in many downgrades, characterised by some observers as an overreaction of the CRAs to "pessimistic perceptions", not backed up by actual infection rates or fiscal deficits (Aninver, 2025). In the years since the pandemic, countries have not regained their previous, higher ratings, reinforcing the perception that CRAs are "slow to upgrade countries after improvements, yet quick to downgrade at early signs of trouble" (Aninver, 2025). Often, the downgrading of a credit rating becomes a self-fulfilling prophecy, or at least strongly reinforces the 'signs of trouble' it purports to reflect. This procyclicality is another key criticism of credit ratings relevant to LMICs: agencies downgrade during crises, which exacerbates those crises by increasing borrowing costs and thereby hampering governments' ability to respond (Aninver, 2025). More generally, the timing of the downgrades in the early 2020s has also significantly reduced governments' ability to invest in the implementation of their NDCs and the SDGs.

How credit ratings influence government decisions

Though rating agencies claim that their assessments merely reflect risks and that they do not seek to influence policy or regulation, in reality they have great influence on government decision-making. When certain policies or government actions result in downgrades and others do not, and when downgrades have such severe impacts on governments' ability to finance crucial services and long-term development, it becomes impossible for governments not to be influenced. As UNDP notes, rating agencies align with the Bretton-Woods institutions in their "bias against most forms of government intervention" (UNDP, 2023). The African Union even claims that "the regulation of national economies has literally shifted from state governments to international CRAs" (APRM, 2025).

Many of the ways in which governments are influenced by rating agencies are detrimental to the energy transition and long-term sustainable development more broadly. For example, rating agencies place high importance on reserve levels held by LMICs, which can result in overinvestment in low-yielding assets instead of in long-term growth (UNCTAD, 2025). In addition, rating agencies tend not to recognise the long-term stabilising impact of investments in climate resilience. They 'reward' efforts by countries to improve their fiscal position, even if this results in chronic underinvestment in badly needed resilient infrastructure (Hurley, Wilkinson & Aitken, 2025). Finally, many LMICs have adopted international banking regulations such as Basel III, to signal to rating agencies that their banks are well regulated. However, these regulations were designed by and for countries with complex banking systems, and their applications in countries with much simpler systems can cause a variety of risks and costs. For example, Basel II and III mandate a focus on financial risks that are largely irrelevant in many LMICs, while not adequately addressing risks to which LMICs are much more exposed than HICs, such as swings in global commodity prices (Beck, Jones & Knaack, 2019).

Rating agencies have similar influence on MDBs. These institutions must retain their AAA rating to be able to operate, and to reduce the risk of downgrades, they issue primarily debt (Civil Society Calls for..., 2023) and hold more liquidity than required to ensure stability (Powell, 2024). By motivating MDBs to prioritise the preservation of their ratings over the direct pursuit of sustainable development, the current system further reduces the amount of concessional capital available to fund LMIC priorities (Mazzucato & Vieira de Sá, 2025). However, at the October 2025 World Bank meetings, S&P announced, in

response to the GEMs database findings and the general momentum around revisiting risk assessments, that it would revise its credit rating assessment methodology for MDBs to allow them to invest more of their capital without risking their AAA ratings. S&P itself estimated this could unlock $600-800 billion in additional development financing (Humphrey, 2025).

By reducing the range of projects viewed as 'investable', low credit ratings also contribute to extractivism and exploitation of LMICs. The main category of projects that are deemed investment-grade in countries with sub-investment grade sovereign ratings are 'enclave resource projects'. These are isolated and export-oriented to maximise protection from political and national economic risk factors, with most of the work carried out, and most of the profits made, by foreign companies. These types of projects provide very few benefits to local economies and populations and perpetuate neo-colonialist trends of resource extraction from LMICs (Aninver, 2025). Examples include mining operations with minimal local involvement, or offshore oil rigs which do not use local ports. The dominance of such investment in some countries hampers sustainable long-term economic transformation, as natural resources are extracted rather than harnessed as foundations for local industries (Atta-Mensah, 2025; IEA,2023).

2.1.1. What can be changed about the credit ratings system?

Many articles and reports consulted for this paper advocate for changing the way credit ratings are determined and used, but very few contained concrete pointers for how this might be accomplished. This is because changing the system is difficult. Credit rating agencies are private companies that are paid to undertake assessments; this both limits the extent to which they are willing to be transparent about their methodologies, and the influence other actors have on these methodologies.

In the literature consulted, three key requests are made to rating agencies.

1. Firstly, to stop downgrading countries that participate in debt relief or debt restructuring programmes. Fear of being downgraded now prevents many countries from using the available mechanisms for debt restructuring; and downgrades reduce the fiscal benefits of debt restructuring for countries that do participate (see also 2.2; APRM, 2025; UNCTAD, 2025).
2. Secondly, to consider applied de-risking instruments in their ratings of bonds and other instruments. LMICs and investors now use a range of instruments to reduce investor risk, including risk insurance facilities, catastrophe bonds, and climate-resilient debt clauses, but as long as these are not considered in credit ratings, many institutional investors are still legally prevented from benefiting from these opportunities (Hurley, Wilkinson & Aitken, 2025).
3. Thirdly, to enhance transparency around their methodologies, so that governments can both prepare for and effectively participate in ratings processes, and credibly challenge these when they believe them to be flawed.

The African Union, concerned about perceived bias in sovereign credit ratings, has announced its intention to establish its own CRA to challenge the hegemony of the 'Big Three' (Cash, 2025). While the launch of this African Credit Rating agency (AfCRA) has generally been applauded, it may struggle to succeed in its mission. Firstly, several other countries or regional blocs, including India and the European Union, have previously launched CRAs with the same goal, but have failed to meaningfully challenge the Big Three. Secondly, AfCRA's credibility may be affected by the fact that it will assess the same institutions that created it, namely African governments. To be credible, AfCRA will need to be independent. However, independent rating agencies that manage to gain momentum are often bought up by the Big Three. For example, GCR Ratings, the largest rating agency in Africa, was purchased by Moody's in 2022 (APRM, 2025; Mo Ibrahim Foundation, 2025).

Regardless of whether AfCRA manages to issue sovereign ratings that challenge those of the Big Three, however, it can play an important role by strengthening African governments' capacity to engage with rating agencies and manage ratings processes (Mo Ibrahim Foundation, 2025), and by focusing on areas underserved by the large agencies. The competition it will generate may also result in the large agencies refining their methodologies for assessing risk in Africa (Aninver, 2025). AfCRA could also help improve countries' access to regional financial markets; Cameroon recently contracted Ivorian credit rating agency Bloomfield Investment Corporation to issue a local-currency sovereign rating for this purpose (Malloum, 2025).

It is important not to forget that ratings by the large agencies are costly; they are unaffordable for small projects and funds, and even for small countries. Nearly 50 LMICs, including 22 African countries, still do not have ratings and also require support. Some experts call for the establishment of an unofficial rating agency managed by the United Nations, in the form of an expert group that can provide guidance and preliminary ratings to countries that are as yet unrated (UNCTAD, 2025).

2.1.2. How can LMICs work better with the credit rating system?

In addition to seeking changes in the credit rating system itself, there is also scope for LMIC governments to improve rating outcomes by engaging with the system more effectively. The main actions governments should take are to enhance the availability and quality of data relevant to risk assessments, and to build domestic expertise on assessment processes. These can support more accurate ratings and also help governments to challenge inaccurate ratings (Aninver, 2025; Mo Ibrahim Foundation, 2025).

Governments should also enhance transparency more generally, and discuss risk more proactively with investors, analysts and the international media, especially in times of instability (Mo Ibrahim Foundation, 2025). In the past years, there have been a few cases of downgrades after it became evident that LMIC governments had underreported public debts, either as a result of poor data management or on purpose (Gondrand et al., 2025; Kakpo & Quenum, 2025). For example, Senegal was downgraded from B1 to B3 by Moody's in 2023, after a government audit found that public debt was around 25% larger than previously reported. The government blamed the previous administration (Kakpo & Quenum, 2025). In cases like this, governments could focus their messaging on reestablishing trust by ensuring processes are in place to prevent such underreporting in the future. Rating agencies could take a more constructive approach by acknowledging the fact that, although credit risks may be increased by greater debt, they are at the same time reduced by greater transparency, and not immediately 'punishing' a government for this transparency.

2.1.3. How can HICs work better with the credit rating system?

Besides changing how credit ratings are formed, the international financial system and especially high-income countries can also change how they are used. Currently, credit ratings are highly influential not just because they are trusted, but also because they hold legal weight; certain institutional investors, such as pension funds, are legally barred from holding securities with credit ratings below investment-grade (UNDP, 2023). Even when de-risking approaches are applied to below-investment grade securities, so that investment risk is minimised to a level that would be acceptable to these institutional investors, the bans still apply. Instead of waiting for CRAs to change their methodologies to consider de-risking, governments could change these regulations and unlock vast amounts of finance.

2.2. DEBT RESTRUCTURING

Debt restructuring, including through debt swaps, can reduce debt service burdens on LMIC governments. This not only frees up budget for investment in essential services and long-term development, including in the energy transition, but as debt ratios are factored into credit risk assessments, it can also reduce CoC. However, current debt restructuring mechanisms have limited effectiveness, due to the way they are designed, but also because of how debt restructuring is regarded by CRAs. In addition, the changing composition of LMIC public debt, especially the growing importance of China and private creditors, adds even more complexity to already highly challenging processes.

During the COVID-19 pandemic, the G20 Debt Service Suspension Initiative sought to bring relief to LMICs struggling to keep up with payments; but countries that participated were downgraded. This also had the secondary effect of discouraging many countries that qualified for, and badly needed, debt relief from seeking support (APRM, 2025; UNCTAD, 2025). The same fears also prevent countries from engaging in debt restructuring programmes such as that offered under the G20 Common Framework.

Debt restructuring is offered by creditors to LMIC governments to reduce the pressure on public budgets and allow for investments in long-term development. Debt-for-development and debt-for-climate swaps include conditions for what the savings can be used for (e.g. the energy transition), and allow these savings to be counted as climate finance provided by creditors. In the view of rating agencies, however, such debt swaps usually occur when a lender is likely to default; only if the creditor does not expect to receive the projected returns are they willing to settle for less. Hence, rating agencies view many debt swaps (especially those benefiting debtors with a rating of Caa1 or lower) as defaults and they downgrade the debtors' ratings accordingly (Nestmann, 2022). Rating agencies are not configured to consider any humanitarian intentions behind creditors' decisions to engage in debt restructuring, or to consider that investments in resilience made as a result of debt swaps are likely to reduce default risk; nor do they recognise that debt restructuring also serves creditors, as it is a way to 'provide' climate finance, as committed under the UNFCCC, without needing to free up additional budget.

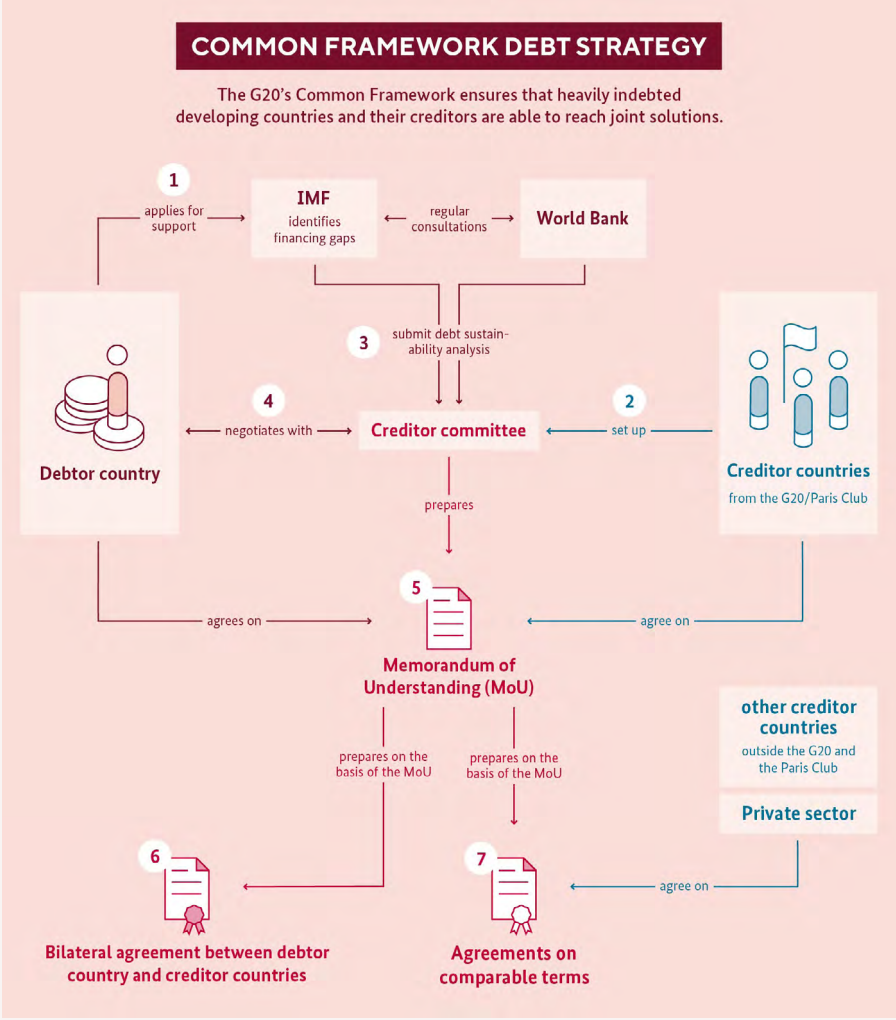
Why debt relief mechanisms have had limited effectiveness

The Common Framework is a mechanism for debt restructurings established by the G20. Its effectiveness has thus far been limited due to the complexity and length of the processes it involves, and because the relief that results from these processes tends to be insufficient to improve a country's fiscal situation, especially if it is accompanied by a credit rating downgrade (Kenewendo, Njoroge & Dryden, 2024; Zucker-Marques et al., 2025).

Debt restructuring processes are becoming more complicated as the composition of public debt changes; whereas previously, the majority of African countries' debt was owed to MDBs and HICs, by 2023, 42% of African countries' external debt was to private creditors (Harcourt, Rivera & Robertson, 2025; Ngundu & Cilliers, 2025). The share of debt owed to China is also growing rapidly (Ngundu & Cilliers, 2025). In recent years, there have been instances of China refusing to accept the debt restructuring framework agreed by other official creditors, and of private creditors disagreeing or delaying procedures (Mani, 2025). Further adding to this complexity is the fact that the Chinese government provides loans through dozens of different government-linked financial institutions, which do not coordinate amongst themselves but instead participate in negotiations as separate parties (Zafar, 2025).

The changing composition of LMIC public debt also has other consequences. Private creditors employ different conditions and due diligence processes than multilateral financial institutions. Whereas MDBs provide loans primarily for infrastructure investment and would not approve loans to plug budget deficits, not all private creditors apply the same restrictions or conduct enough due diligence to ensure loans are invested in long-term growth (Ngundu & Cilliers, 2025). This can further reduce the viability of countries' debt burdens. Different bilateral creditors also apply different conditions. For example, whereas MDBs require that investments are aligned with national policies and strategies, China merely requires that requests be conveyed by the highest political authority in a country, usually the office of the president or prime minister. This practice is susceptible to abuse, as leaders have used Chinese financing to strengthen their own political position, by rewarding allies, weakening the opposition and building patronage networks (Cao & Lin, 2025).

Figure 4: German Federal Ministry of Finance (2025)



2.2.1.
Initiatives and proposals to improve debt restructuring processes

Initiatives proposed or launched to improve debt restructuring processes include:

- There have been calls for the formation of a Global South Debtors' Coalition, to improve the bargaining power of LMICs vis-à-vis their creditors (Kaboub & Chiriboga, 2025). There are risks involved, especially if the coalition takes ambitious action, as creditors are likely to attempt to break up the coalition or reduce its effectiveness. However, learnings from previous attempts at debtor coordination, such as the Cartagena Initiative in the 1980s, show that the mere existence of a debtors' alliance can change the power dynamics in negotiations, and improve the position of debtor countries (Ampofo-Anti et al., 2025; Guzman, Colodenco & Wiedenbrüg, 2024; Kaboub & Chiriboga, 2025).
- The International Monetary Fund (IMF) requires rapid fiscal consolidation, in the form of austerity measures, as part of debt restructuring. This approach is increasingly challenged, including by UNDP. According to UNDP, "rapid fiscal consolidation is detrimental to the fulfilment of SDGs", and countries should prioritise social spending and investment in the SDGs instead. UNDP advised several African countries, including Ethiopia, to define an annual ceiling for debt service payments and to ringfence budgets for social expenditure (Zafar, 2025).

2.3.
REFORMING GLOBAL SYSTEMS

Reform of the global financial architecture has been heavily promoted by successive G20 Presidencies and other international and LMIC actors; one analysis identified 71 separate policy proposals for reform (McNair, 2024). Though this proliferation of campaigns signifies positive momentum that is likely to lead to broader acceptance of the need for reforms, it also threatens to dilute the impact of any one campaign's messaging (Diwan, 2025). In the current political climate, there is also the risk that uncoordinated calls for reform could be hijacked by actors who wish to dismantle, rather than reorganise, flawed international institutions. It is therefore important for existing initiatives to coordinate and build on the current momentum to drive effective reforms (McNair, 2024).

Though the exact contents of the 71 proposals vary, actors are calling for (McNair, 2024):

1. The unlocking of increased volumes of concessional finance, the deployment of more agile and flexible loan instruments, and broadening of eligibility criteria for concessional finance to include middle-income countries that are highly vulnerable to climate change
2. Improvements to risk assessments, including those by credit rating agencies, as well as IMF and World Bank debt sustainability assessments
3. Increased representation and influence of LMICs in the governance of international institutions
4. Reforms of debt governance

The sections below elaborate further on points 1, 2 and 3.

The Global Tax Agreement, in which the OECD and G20 played leading roles, is an example of international coordination that led to reforms that would have been viewed as impossible not too long ago. Though Pillar One of the GTA has not yet been agreed, Pillar Two, which introduces a global minimum tax of 15% to be paid by multinational companies in countries where they operate, is already being implemented: as of August 2025, 65 countries had drafted or adopted legislation transposing this into domestic law (Bunn & Bray, 2025).

Initiatives - campaigns for reform

Initiatives calling for reforms to the global financial architecture include:

The South Africa G20 Africa Expert Panel Report, handed over on 18 November 2025, offers strategic advice on solving Africa's debt crisis (Diwan, 2025). It builds on the G20 Common Framework, arguing for debt refinancing by using low-cost loans to repurchase foreign currency debt, utilising special drawing rights and selling the IMF's gold reserve. Establishing closer cooperation between the G20, the World Bank, the IMF and a to-be-established borrowers club should increase debtor country negotiation leverage, solve transparency issues and boost investment in Africa.

The Report calls for four specific reforms: including middle-income countries in the Common Framework; pausing debt servicing during negotiations; working in parallel to accelerate debt restructuring; clarifying rules for creditors and equalising domestic and foreign debt standards.

The Bridgetown Initiative is a call for reform of the global financial architecture. It argues that as this system was designed prior to decolonisation and before environment, climate change and gender were priorities, it is no longer fit for purpose (McNair, 2024).

The Pact for Prosperity, People and the Planet, initiated by the French government, is a collaborative platform endorsed by 70 countries, which promotes four core principles: "no country should have to choose between fighting poverty and addressing climate change"; "each nation must define its own transition strategy"; "significantly more public finance is needed for vulnerable economies"; and "private finance must be mobilised at greater scale."

Figure 5: 4P leaders convening at the Fourth International Conference on Financing for Development to discuss the Pact for Prosperity, People and the Planet, source: 4P website (2025)

2.3.2. MDB reforms

One proposal to unlock new concessional financing, included in the G20 Roadmap for MDB reform, is to reallocate the IMF's Special Drawing Rights (SDR) – reserve assets provided by IMF that can be used to provide liquidity to countries in times of crisis. The current quota shares do not reflect needs, as most SDR are allocated to the largest economies. For example, when the IMF reallocated $650 billion in SDR to support governments during the COVID-19 pandemic, just 5% of this total went to African countries, less than the share received by Germany alone (Ashmore & Strid, 2025). The SDR quotas could be adjusted and the newly allocated SDR channelled through regional MDBs, to expand their ability to fund projects (Ashmore & Strid, 2025).

Many other proposals do not even require the reallocation of funding from elsewhere. As discussed previously, MDBs are conservative in terms of the liquidity they hold, because the investments they make are deemed high risk and to preserve their own credit ratings. For each $1 provided to MDBs, over $0.30 is invested in short-maturity, high-rated assets from HICs, rather than lent to LMICs (Powell, 2024). However, the new evidence from the GEMs database shows that MDB sovereign lending is much less risky than previously thought. This means that MDBs should be able to stretch their capital further, especially for investments in energy projects, which, as mentioned above, were found to be less risky than average (Gregory, 2024). Changes in this direction are already underway; the Independent Review of MDB Capital Adequacy Frameworks, commissioned by the G20 under Indonesia's Presidency in 2022, resulted in a series of recommendations that the MDBs have committed to implementing. These recommendations appear to also have contributed to S&P's decision to revise its rating methodology for MDBs (Humphrey, 2025).

Another proposal is to combine the previous two ideas by using SDR to back a liquidity line provided by major central banks to the four regional MDBs, so that they can reduce the volume of liquidity they hold (currently over $200 billion), channelling some of this into investments, without threatening their stability (Powell, 2024).

Besides unlocking additional financing, many actors are also calling for changes to how debt is viewed by the IMF and World Bank. The current Debt Sustainability Framework views capital expenditure (e.g. investment in energy transitions) as identical to regular government spending – the value of the assets invested in does not show up on the balance sheet, and effects on long-term growth are not considered. Therefore, the framework, much like the credit rating system, "privileges immediate fiscal consolidation over long-term developmental outcomes" (Mazzucato & Vieira de Sá, 2025). Many experts call for this to be changed, arguing that borrowing externally for public investment spending is viewed as a sound long-term development strategy, especially for LMICs with rapidly growing populations and economies (CCSI, 2025).

2.3.3.
Reform of Basel III and other banking regulations

Basel III refers to the international standards and minimums for bank capital requirements, stress tests, liquidity regulations and leverage, adopted after the 2008 financial crisis (Hott, Munzele & Ould Tah, 2025). Though the framework played an important role in preventing another banking crisis, it has also hampered investment in infrastructure in LMICs (Songwe, Frazer & Henry, 2025). In addition, as mentioned in Section 2.1, it was developed without significant input of, and is largely unfit for application in, LMICs. Despite this fact, many LMICs have applied it domestically, as there is no other credible way to signal to ratings agencies and international financial institutions that their banking sector is well regulated (Beck, Jones & Knaack, 2019).

Basel III includes stringent rules on the levels of capital banks must hold to cover the risks of different types of investments, and the requirements it imposes on banks investing in infrastructure in LMICs are widely understood to be disproportionate. For example, the framework's Internal Ratings-based approach assumes that infrastructure project risk increases linearly over time, whereas in fact risks decrease significantly once projects are past the construction and commissioning phases and begin generating revenue (ICC, 2025; Songwe, Frazer & Henry, 2025). Banks are required to hold large volumes of capital over the entire lifetime of an infrastructure project, tying up significant funds for potentially decades. It should be relatively straightforward to, based on available evidence, allow banks to reduce their capital holdings for infrastructure loans over the course of the project (Songwe, Frazer & Henry, 2025). Similarly, the European Union's Solvency II framework saddles insurers investing in LMIC infrastructure projects with a 49% capital charge—against 25% for similar projects in HICs—despite the lack of evidence supporting such a large difference in requirements (Songwe, Frazer & Henry, 2025).

Banking regulations such as Basel III also limit the impact of de-risking mechanisms, by not reducing the capital charges/requirements even when MDBs take on the majority the risk of an investment (Songwe, Frazer & Henry, 2025). This is partly the result of misalignment between banking rules and regular MDB processes; for example, Basel III requires any guarantees to be unconditional, whereas guarantees provided by MDBs always include exclusions (though these are rarely applied). Another example is that Basel III requires fast payouts in the event of defaults, which is incompatible with MDBs' arbitration rules. The framework does provide a special 0% risk weighting for MDBs, but not all MDBs qualify for this (ICC, 2025).

These incompatibilities are not inevitable; governments have control over both Central Banks, which jointly develop international regulations such as Basel III, and MDBs. They could be more proactive in ensuring that the actions and procedures of both are aligned. Governments can also use banking regulations to signal support for investment in specific sectors; for example, the EU's Infrastructure Supporting Factor reduces risk weights for certain infrastructure projects, which has "materially improved the economics of long- tenor investments in Europe" (ICC, 2025). Similar instruments could be imagined for infrastructure investments in LMICs, especially for important and low-risk sectors such as renewable energy. The International Chamber of Commerce estimates that specific clarifications and reforms of Basel III could triple or quadruple private bank capital available for sustainable infrastructure investment in LMICs, without increasing instability (ICC, 2025).

2.4. REDUCING THE RISK

Historically, the global financial architecture has placed the responsibility for reducing cost of capital squarely with LMIC governments. As we have seen, recent years have seen growing recognition of the influence on CoC of inequalities built into global systems, and of problems with investment risk assessments and how these are used. However, this does not mean that there is no need for de-risking at all. It is important to avoid the prevention paradox—lower than expected default rates can be the result of flawed ex ante assessments but can also be evidence that de-risking works. This section discusses some de-risking activities, by governments, MDBs and other actors, that continue to be recommended.

2.4.1. Domestic de-risking activities

The recent literature about reducing the cost of capital no longer recommends aggressive fiscal consolidation, including through austerity measures. Instead, it recommends the following activities by LMIC governments and private sector actors:

- Improve data availability and transparency, so that rating agencies and investors can more accurately assess risks, and governments can credibly challenge assessments that are inaccurate. Governments can also proactively provide market information to investors to mitigate knowledge gaps and promote opportunities.
- For renewable energy projects specifically, off-taker risks, or the risk that a buyer of electricity will default or otherwise not pay, are a significant factor in CoC. These risks can be reduced by strengthening utilities, for example by adopting cost-reflective energy tariffs and improving collection rates (Stedile & Gordon, 2025).

- Enhancing the financial and digital literacy of the private sector, especially of homegrown companies in sectors such as renewables and off-grid electrification (Mo Ibrahim Foundation, 2025).

As the impacts of climate change become more visible and more damaging, some LMICs, especially small island developing states (SIDS), will find that there are limits to how much domestic de-risking can achieve. Many SIDS face debt and CoC problems—due to climate vulnerability, combined with small market sizes and high import costs—despite having made all required policy and regulatory reforms. For SIDS and other highly vulnerable countries, concessional financing will always remain needed (Hurley, Wilkinson & Aitken, 2025).

INITIATIVES

The University of Oxford and Imperial College London, through the Climate Compatible Growth (CCG) Programme, have developed the Model for Informed National Financing (MINFin) to support the financial planning of energy projects in LMICs. The tool can model construction costs, capital costs, and revenues for energy projects. It helps to assess financing gaps and also allows users to identify strategies to close these (Briel & Fankhauser, 2025).

The International Energy Agency has launched the Cost of Capital Observatory, which collects and displays up-to-date information on CoC for energy projects in LMICs. It also offers tools and analysis to support accurate risk assessments, and case studies of successful risk mitigation and energy project financing (Stedile & Gordon, 2025).

The previously mentioned Global Emerging Markets Risk database is an excellent example of enhanced transparency and data availability ultimately resulting in reduced CoC and increased availability of concessional financing (Humphrey, 2025; Reuters, 2025).

Pacific Trade Invest is a regional platform managed by the Pacific Community, which proactively provides information to investors seeking to enter the region as well as regional businesses investigating export opportunities.

2.4.2. Blended finance and de-risking

Blended finance and de-risking instruments use concessional (public or philanthropic) capital to mitigate some of the risks of investing in LMICs. They aim to make such investments more attractive to private investors and thereby unlock capital flows that would otherwise not be directed towards LMIC projects. In recent years, 'blended finance' as a concept appears to have become a victim of overenthusiastic marketing; in the past, it was hailed by some as a silver bullet solution to financing problems, and proponents predicted that after an initial, publicly sponsored push, new markets in risky sectors and geographies would soon be kickstarted and the private sector would crowd in without needing further encouragement. As a result, some actors applied the approach too broadly, also in sectors where it was never likely to be effective (Mazzucato & Vieira de Sá, 2025).

Criticisms of blended financing approaches include:

- Using public or philanthropic finance to absorb losses and protect profits for the private sector is another way of privatising benefits while socialising costs. This can create situations whereby 1) the private sector exaggerates risks to encourage a public or philanthropic funder to become involved and absorb any losses, and 2) the private sector neglects to do proper due diligence, because it is not liable for any losses anyway (Bigger, 2023).
- Proponents of blended financing approaches say they are needed because there is insufficient public financing to meet the SDGs and fund the energy transition. Opponents argue that it is not a matter of availability but one of priorities; tax avoidance and evasion costs countries hundreds of billions each year, plus high-income countries have consistently failed to meet their ODA and climate finance commitments (Mazzucato & Vieira de Sá, 2025).
- There is too little evidence of the development impact of blended finance, partly because success is often measured and reported primarily in terms of additional finance leveraged, and because transparency is limited by the involvement of private sector parties (Mazzucato & Vieira de Sá, 2025; Oxfam, 2017).
- Even the impact in terms of leverage rates tends to be low; for example, the World Bank leveraged just $0.25 in commercial financing for every $1 of public financing invested (Bigger, 2023).
- Whereas publicly financed projects can be fully aligned with country needs and priorities, involving private sector parties usually requires a degree of compromise. Especially when leverage ratios are low, this compromise is not always worth it (Mazzucato & Vieira de Sá, 2025).
- The additionality of blended finance—the fact that a project would not have been financed without blending or de-risking—is not always easy to prove, especially in the renewable energy sector, which already attracts high volumes of commercial capital (Saffar & Tam, 2022).
- Most blended finance is directed towards well-established sectors in middle-income countries, and it does not reach the poorest or most vulnerable (Oxfam, 2017).
- Blended finance recasts the role of governments and MDBs, turning them into mere de-riskers and facilitators of activities by private actors, when instead they should be shaping markets and directing investment to drive just transitions (Bigger, 2023; Civil Society Calls for..., 2023).

While these criticisms are all valid, they mostly relate to scenarios where blended finance is used to the exclusion of any other types of finance or support. Blended finance is a broad term that includes a range of different tools and instruments, all suitable for different contexts and applications. We have seen examples of well-designed instruments, deployed appropriately, as well as misapplied, poorly designed ones. Blended finance should be viewed as one of a range of approaches, alongside rather than instead of grant financing.

GOOD PRACTICE INITIATIVES

A sample of good practice blended finance instruments promoted by different actors, derived from the literature and interviews with experts, is presented below.

Guarantee schemes/ facilitation programmes:

The **World Bank's** **Multilateral Investment Guarantee Agency** **(MIGA)** simplifies access to financial guarantees for development projects in LMICs.

The NORAD Guarantee Scheme provides guarantees for renewable energy investments in LMICs.

A Global Credit Guarantee Facility to reduce the CoC for renewable energy investments in LMICs is still in the proposal stage (Gautam, Purkayastha & Widge, 2023).

Initiatives to enhance debt sustainability:

The Global Small Island Developing States (SIDS) Debt Sustainability Support Service (DSSS) is a compact that will support coordination to tackle debt in SIDS by including debt/pause clauses in sovereign debt agreements; extending parametric insurance to provide quick capital in case of specific climate events; promoting debt-for-nature and debt-for-climate swaps; and facilitating creditor coordination.

The African Financing Stability Mechanism, to be established by the African Union and African Development Bank, will offer debt refinancing and liquidity backstopping to African governments, to stabilise economies in times of crisis and reduce reliance on external lenders.

Blended funds/portfolios:

The **IFC's** Managed Co-lending Portfolio Platform (MCPP) allows institutional investors and credit insurance companies to invest together with IFC on commercial terms, benefiting from IFC's origination and due diligence experience. It has raised over $19 billion since 2013, across several portfolios including MCPP One Planet, which includes Paris Agreement-aligned loans to LMICs.

The ILX Fund allows pension funds and other institutional investors to co-invest in MDB and DFI loans to LMICs pari-passu (sharing risk, proceeds and losses equally), in sectors including infrastructure and renewable energy.

Other good practice examples include: REPP/REPP2, Amundi SEED, Blue Orchard Fund and Climate Investor One.

Insurance schemes:

Africa Trade & Investment Development Insurance (ATIDI) provides investment insurance against political risk. It also supports member states to establish de-risking mechanisms, for example working with the Central Bank of the Democratic Republic of the Congo to deploy a credit risk guarantee facility for local commercial banks (ATIDI, 2023).

The V20 Sustainable Insurance Facility is developing a suite of de-risking solutions for micro-, small- and medium-sized enterprises in climate vulnerable countries.

2.5. FINDING NEW SOURCES OF FINANCE

An additional lever to lower cost of capital is to identify more sources of concessional finance. In 2023, just 11% of climate finance was concessional finance, with the remaining 89% made up of market-rate debt and equity instruments (Naran, Zhang & Gupta, 2024). If the share of concessional finance can be increased, that will directly reduce the weighted average cost of capital that LMICs face.

2.5.1. Redirecting finance from other uses

Gap analyses, which highlight how much additional financing is required for the energy transition and the SDGs, usually present financing gaps as an absence of funds, rather than the result of choices that direct funds elsewhere (Bigger, 2023).

For example, in 2022, fossil fuels were subsidised globally to the tune of over $7 trillion, while tax base erosion and tax avoidance, including by multinational companies, deprive states of over $600 billion annually (Mazzucato & Vieira de Sá, 2025). In addition, international illicit financial flows cost African countries $88 billion in 2020 (Mo Ibrahim Foundation, 2025). These figures far exceed total ODA and climate finance, as well as financing needs for the energy transition.

As mentioned previously, there is also an opportunity to rechannel Special Drawing Rights. These are allocated primarily to HICs, most of which do not use them. The G20 made a commitment to divert $100 billion worth of SDR to LMICs, but this has not yet happened (Powell, 2024).

2.5.2. Domestic/regional finance

African countries and other LMICs have an enormous opportunity to increase domestic financing for the energy transition and broader sustainable development, to complement external support. A major benefit of domestic investment is that it avoids currency risks. The literature recommends the following long-term strategies, which also all have broader benefits:

- **Increasing domestic revenue:** Tackling the above-mentioned tax avoidance and illicit financial flows, as well as corruption, while also increasing the tax-to-GDP ratio (16.5% in Africa compared to 33.5% in OECD countries). This would require broadening the tax base and some formalisation of informal sectors (Cilliers, 2024). In combination with measures to increase financial inclusion, this would also increase the depth of domestic financial systems, which is a significant factor in credit ratings (Cilliers, 2024).
- **Strengthening national development banks (NDBs):** NDBs have the advantage of good knowledge of local markets and risks, and can lend in local currencies. However, their involvement in infrastructure investment is hampered by limited access to international finance, narrow mandates, and weak governance structures. MDBs can support the mobilisation of NDBs by focusing on their strengthening and capitalisation, channelling lending through NDBs rather than to projects directly (Carvalho, 2025).
- **Promote domestic investment:** Africa's institutional investors manage over $2.1 trillion in assets, a share of which could be directed towards infrastructure and private sector financing by, e.g., aligning pension fund regulations with national development priorities (AfDB, 2025). In a good practice example, pension fund regulators in Nigeria now allow pension funds to allocate up to 15% to infrastructure and private equity investments, up from 5% previously (Hill, 2025). Meanwhile, Africa's high net-worth individuals own $2.5 trillion in liquid investable wealth but tend to invest outside the continent (Mo Ibrahim Foundation, 2025). The diaspora can also be mobilised: according to officials, Senegal's September-October 2025 local currency bond issue saw strong participation from the country's diaspora in over 45 countries (Kakpo & Quenum, 2025).
- **Enhance regional integration and boost regional investment:** Several West African countries, including Côte d'Ivoire and Senegal, have begun issuing local currency bonds (in West African Francs, CFA, which is pegged to the Euro) on the West African Economic and Monetary Union (WAEMU) market. Another innovation is the small entry ticket size, at just CFA 6.55 million/ EUR 10,000, which attracts smaller investors, including members of the diaspora (Kakpo & Quenum, 2025) (Ecofin Agency, 2025). Growing inter-African investment flows has other benefits too; in 2017, 88% of transactions between African countries were cleared outside the continent, adding $5 billion in transaction costs that could be avoided through stronger regional banking systems (Mo Ibrahim Foundation, 2025).

GOOD PRACTICE INITIATIVES

This list presents examples of initiatives launched by LMIC organisations to unlock domestic and regional financing for the energy transition.

InfraCredit Nigeria, a private company established by GuarantCo and the Nigerian Sovereign Investment Authority, provides local currency guarantees for infrastructure projects in Nigeria, and has secured over $300 million in long-term financing (AfDB, 2025; IISD, n.d.).

The **African Development Bank (AfDB)** Capital Market Development Trust Fund, capitalised by Sweden, Luxembourg and the Netherlands, supports the development of domestic capital markets in African countries, in line with climate and sustainability goals, as well as the integration of capital markets to enhance their resilience to shocks (AfDB, 2025).

The African Exchanges Linkage Project, launched by the African Securities Exchanges Association (ASEA) and the AfDB, facilitates cross-border trading of securities in Africa, to strengthen regional capital markets.

The **AfDB's** African Green Banks Initiative strengthens the capacities of private and public banks and microfinance institutions with the aim of building an Africa-wide network of Green Banks able to raise large volumes of financing to invest in climate action.

The New Development Bank, an MDB established by the BRICS countries in 2015, aims to provide local currency lending. However, it has faced issues due to the volatility of its members' capital flows and their low credit ratings; unlike the major regional development banks, it does not have high-income non-regional countries as shareholders. As a result, it has had limited impact thus far and has primarily issued loans in USD and EUR (Mattos & Godinho, 2025).

SUMMARY

SUMMARY

1. **The high Cost of Capital (CoC) in low- and middle-income countries (LMICs) forms a major barrier to just energy transitions.** As renewable energy generation requires high upfront investments while incurring very low operational costs, the feasibility of renewable energy projects is significantly affected by the cost of that upfront investment. In countries where the CoC is high, due to a range of factors including low sovereign credit ratings, renewable technologies therefore remain more expensive than fossil fuel-based ones, even if the former are already competitive in other geographies. At the same time, investment in renewable energy generation is less risky than many other energy transition-related investments due to the established business models and mature technologies. If the cost of capital is to be lowered in any segment, it should be renewable energy generation.

2. **There is significant momentum for tackling the cost of capital, which has the potential to lead to innovation, but it must also lead to long-term changes and action at scale.** With so many actors in the space and given the long lead times of many of the structural changes required, it is important to be wary of innovation for the sake of innovation, and of the dismissal of tried and tested mechanisms before they have been given a real chance to succeed. Changes in capital markets and international financial infrastructure take time and significant investment, as do major infrastructure deals. Even more than designing new instruments, it is important to replicate and scale what works.

3 **Relatedly, it is important to have nuanced discussions about the usefulness or lack thereof of different instruments.** Blended finance, in particular, has come under significant fire recently, with critics claiming that its underlying arguments are flawed and that it has not delivered the promised impacts. Two major factors have contributed to the disillusionment with blended finance. Firstly, unrealistic expectations – blended finance is not, and should never be presented as, a silver bullet or the best solution for every problem, but rather as a useful tool among many. Secondly, the conflation of a range of de-risking and other mechanisms and approaches under the blended finance moniker, including many flawed and many excellent instruments. It is true that many blended finance instruments have been poorly designed and/or applied to inappropriate contexts; this does not negate the usefulness of blended finance overall.

4 **Credit ratings are a major cause of high cost of capital, and many actors argue they are flawed.** While the major credit rating agencies (CRAs) present their methods as fair, sound and transparent, several reputable studies have presented evidence of flaws. Among African governments and civil society organisations, in particular, the overwhelming consensus is that credit ratings are biased. A growing body of evidence shows that risks of defaults in SSA are lower than credit ratings predict, and that even when defaults occur, recovery rates are high. In addition, actors are increasingly questioning the CRAs' methodology—for example, asking whether national income is as good a predictor of default risk as the CRAs claim. Improving credit ratings requires actions by CRAs, LMIC governments, and the international financial architecture.

5 **Debt restructuring, including through 'debt-for-development' swaps, has had limited impact, partly due to the disconnect between the CRAs and the sustainable development agenda.** Over half of the population of Sub-Saharan Africa now lives in countries that spend more money on servicing debt than on education or healthcare. The debt burdens these countries face significantly impede their ability to invest in energy transitions and long-term climate resilience. Debt-for-development swaps are a way to reduce debt servicing burdens and free up financing for investment in sustainable development. However, the CRAs assume that creditors only agree to such swaps when a default is likely—if it is not, why would they accept lower returns than they were originally entitled to? Therefore, CRAs automatically view most debt swaps as preventing a likely default and downgrade the debtors' ratings accordingly. The CRAs do not consider the fact that debt swaps constitute an abrogation of commitments by creditor countries, too, as they are a convenient way to meet climate finance commitments.

6 **Many frameworks and approaches to reducing debt burdens are hampered by similar disconnects between financial regulators and development agendas.** For example, the Basel III banking regulations, designed in the aftermath of the 2008 financial crisis, include clauses that discourage investment in infrastructure projects in LMICs, even when those projects have been de-risked. Similarly, most countries prohibit pension funds from investing in sub-investment grade assets, even when those investments have benefited from de-risking. Governments can step up to encourage greater coordination between central banks and MDBs.

7 **Energy transition and climate finance 'gaps' are much more the result of skewed priorities than of an absence of funds.** In 2022, fossil fuel subsidies amounted to over $7 trillion globally, while tax avoidance costs states around $600 billion per year (Mazzucato & Vieira de Sá, 2025). And despite all ODA and climate finance provided, the global financial system still extracts more funds from Africa than it injects: between 1970 and 2022, financial outflows from African countries amounted to $2.7 trillion (in debt repayments, capital flight, illicit outflows and tax avoidance), while inflows from ODA and foreign direct investment were only $2.6 trillion (Carvalho, 2025).

8 **A range of reports, articles and op-eds have been published in the past year outlining measures to be taken to lower CoC.** These lists usually include: 1) fix risk perceptions, 2) find new concessional financing, including through de-risking, 3) change international systems such as MDB capital adequacy frameworks, Basel III banking regulations, CRAs, debt relief mechanisms, and how debt is viewed in all these systems (investment in infrastructure ≠ regular spending), and 4) domestic changes: deepen domestic capital markets, build capacity of NDBs, increase tax income/reduce illicit outflows, enhance data availability and improve governance.

There is significant momentum to address CoC, and a range of initiatives have been launched to address all aspects of the issue. Nearly 80% of all publications on lowering CoC consulted for this paper were published in 2024 or 2025. This is a highly positive development, as lowering CoC is a complex matter that requires many actors pulling at different threads. However, more coordination will be needed to ensure all initiatives are working towards compatible goals, and to sustain the incredible momentum behind solving this issue that has emerged in the past year or so. Coordination is also needed to channel this momentum so that it leads to real change, to fairer and more equitable international financial systems that support accelerated, just energy transitions where they are most needed.

Acronym List

ASEA	African Securities Exchanges Association
ATIDI	Africa Trade & Investment Development Insurance
AfCRA	African Credit Rating agency
AfDB	African Development Bank
CRAs	Credit rating agencies
CoC	Cost of capital
DFIs	Development finance institutions
DSSS	Debt Sustainability Support Service
EMDE	Emerging market and developing economies
GDP	Gross domestic product
HICs	High-income countries
IEA	International Energy Agency
IMF	International Monetary Fund
LCOE	Levelised cost of electricity
LMICs	Low- and middle-income countries
MCPP	Managed Co-lending Portfolio Platform
MDBs	Multilateral development banks
MIGA	Multilateral Investment Guarantee Agency
NDCs	Nationally Determined Contributions
ODA	Official development assistance
SDG	Sustainable Development Goal
SDR	Special Drawing Rights
SIDS	Small island developing states
UNCTAD	United Nations Trade and Development
UNDP	United Nations Development Programme
WACC	Weighted average cost of capital
WAEMU	West African Economic and Monetary Union

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