



# Cost of Capital Commission: A Proposal

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# Why a Cost of Capital Commission is needed

Forty percent of the world's population lives in countries that spend more on debt service than health or education.<sup>1</sup> This is particularly a challenge in Africa, where 20 low-income countries are in, or at risk of, debt distress. African countries owe \$655.6 billion to external creditors as of 2022, up from \$283 billion a decade previously, and will pay \$89.4 billion in external debt service in 2024. Debt service as a share of government spending (12%) has surpassed spending on healthcare (7.3%).<sup>2</sup>

Because of these high debt service costs in Africa and elsewhere, net financial flows to 'developing countries' turned negative in 2022, meaning that debt service exceeded official development assistance (ODA) and new financing.<sup>3</sup> A growth in the volume of African debt has been accompanied by the US Federal Reserve increasing interest rates to calm domestic inflation, which both increased debt service costs and strengthened the dollar against local currencies. All at a time when energy and food prices faced pressure in the wake of Russia's invasion of Ukraine.<sup>4</sup>

But Africa's debt crisis is not one of too much debt. In fact, given the continent's demographic trends, the massive human development and infrastructure needs and the challenge of climate change, Africa needs more investment, more domestic resources and more borrowing.

But Africa's borrowing is low in comparison to that of advanced economies. General government net debt as a proportion of gross domestic product (GDP) is 70% in Kenya, 69% in South Africa, 45% in Nigeria and 35% in Ethiopia. These figures are low compared to the US (96%), Japan (155%), Italy (126%), France (102%), UK (92%) and Germany (46%).<sup>5</sup>

## The debt crisis faced by African countries is rather a crisis of debt that is too expensive

Analysis from The ONE Campaign shows that borrowing from capital markets is costing African governments 500% of what it would had they accessed financing at International Bank for Reconstruction and Development rates. As a result, African countries will pay an additional \$56 billion on the debt they raised from capital markets during the five years prior to 2021. This is more than the total ODA to the continent in 2022 (\$53.5 billion).<sup>6</sup> For all middle-income countries globally, this amounts to \$74 billion in additional unnecessary costs for new bonds issued just in 2021.<sup>7</sup>

This has wide-ranging implications for short-term human development and stability – as well as longer-term economic transformation and climate action. The lack of fiscal space undermines African governments' ability to invest in public services and social protection and has prompted some to raise taxes. Protests have ensued in Kenya and may expand to other regions. But it also inhibits investment in the energy transition. For example, in 2023 investments in battery storage reached more than \$40 billion, 90% of which was concentrated in China, the US and Europe. For every dollar invested in battery storage

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<sup>1</sup> Rebeca Grynspan et al., '[A World of Debt Report 2024](#)', (Geneva: UNCTAD, 2024).

<sup>2</sup> Sara Harcourt and Fiona Robertson, "[African Debt](#)", The ONE Campaign.

<sup>3</sup> Sara Harcourt and David McNair, "[Net Finance Flows to Developing Countries Turned Negative in 2023](#)", The ONE Campaign, 2024.

<sup>4</sup> David McNair, "[How Russia's Invasion of Ukraine Will Impact Africa?](#)", The ONE Campaign, 2022.

<sup>5</sup> Calculations by Jorge Rivera based on data from the IMF's World Economic Outlook, 2024.

<sup>6</sup> Sara Harcourt, "Official Development Assistance (ODA)", The ONE Campaign, <https://data.one.org/topics/official-development-assistance/>

<sup>7</sup> Amy Dodd and Jorge Rivera, "[The Collateral Damage of Rising Interest Rates](#)", The ONE Campaign, 2023.

in advanced economies and China, only one cent was invested in other emerging markets and developing economies. High capital and financing costs are considered by the International Energy Agency to be a major contributing factor.<sup>8</sup>

In March 2024, Kenyan President William Ruto joined Ghana and Zambia's presidents, Nana Akufo-Addo and Hakaide Hichilema, in calling out the so-called African Premium, 'based on unfair risk premiums and inaccurate valuation of their economies'.<sup>9</sup> They helped launch the 'Africa Club',<sup>10</sup> an alliance of African multilateral financial institutions to coordinate with global financial institutions and leverage African countries' balance sheets to increase investment and jobs. A decision to establish an African credit rating agency will lead to the creation of the entity in 2025.<sup>11</sup>

## How a Cost of Capital Commission would build on existing G20 action

The G20 has taken important – if insufficient – steps to seek to resolve the liquidity and solvency issues facing emerging markets and unlock additional low-cost capital to support the energy transition and the Sustainable Development Goals. During the COVID-19 pandemic the G20 agreed on a Debt Service Suspension Initiative (DSSI),<sup>12</sup> which temporarily unlocked \$12.9 billion in liquidity from suspended debt service payments to help vulnerable countries respond to the pandemic. The G20's [Common Framework for Debt Treatment beyond the DSSI](#) then sought to support countries facing solvency issues – although this turned out to be less successful, as those countries that applied faced credit downgrades and also saw limited resolution, in some cases for years.<sup>13</sup> The reasons for the lack of progress lie in the complexity of the challenge: the creditor landscape is much more complex, with increasing lending from private creditors and non-Paris club lenders and the incentives for these actors to participate on equal terms in debt-restructuring negotiations. This is in turn complicated by geo-political tensions between the US and China, the latter now Africa's largest official bilateral creditor.<sup>14</sup>

A more successful area of action from the G20 lies in efforts to reform multilateral development banks (MDBs) through the review of Capital Adequacy Frameworks. The initiative, initially spearheaded by prime minister Mario Draghi as Italian president of the G20 in 2021, sought to encourage MDBs to better leverage their balance sheets by adjusting their risk appetites and thus unlocking up to an additional trillion in low-cost lending for middle-income countries, while maintaining their 'AAA' credit rating and arguably then freeing up more concessional finance from these institutions to low-income countries. This agenda was advanced by the Indonesian G20 presidency through an influential expert panel (commissioned by the Italian G20 presidency). The panel conducted an [Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks](#), making five recommendations that informed both the World Bank's 'Evolution Roadmap' and the reform agenda of a number of MDBs.

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<sup>8</sup> International Energy Agency, [World Energy Investment](#) (Paris: IEA, 2024).

<sup>9</sup> Nana Akufo-Addo, William Samoei Ruto and Hakaide Hichilema, "[Three Presidents on How to Make Global Finance Work Better for Africa](#)", *The Economist*, March 6, 2024.

<sup>10</sup> AU, "[Presidential Dialogue on African Union Financial Institutions; Reforms of the Global Financial Architecture; and the Launch of the Africa Club](#)", February 17, 2024.

<sup>11</sup> Moses Mozart Dzawu, "[Ratings Company to Serve Africa Set to Be Ready by Next Year](#)", *Bloomberg*, July 20, 2024; African Peer Review Mechanism, "[Retreat to Finalise Establishment of the Africa Credit Rating Agency: Lusaka-Zambia](#)", March 25, 2024.

<sup>12</sup> World Bank, "[Debt Service Suspension Initiative](#)", 2022.

<sup>13</sup> Mariza Cooray and Robert Walker, "[The G20's Approach on Debt Has Failed](#)", Lowly Institute, 2023.

<sup>14</sup> Harcourt and Robertson, "African Debt."

In April 2024, 10 MDBs agreed on steps to increase lending capacity to the order of \$300-\$400 billion.<sup>15</sup> This includes the Asian Development Bank's unlocking an additional \$100 billion through the framework.<sup>16</sup> The Indian G20 presidency commissioned another expert group under the leadership of Larry Summers and NK Singh, which led to recommendations to triple the firepower of MDBs, including through increasing the volume of the International Development Association: the World Bank's low-income country fund.<sup>17</sup>

The outcomes of this work were endorsed in the G20 New Delhi Leaders' Declaration in 2023.<sup>18</sup> These steps are important not only for the volume of additional lending they could unlock but also, critically, because they can offer an alternative to those countries that otherwise use expensive Eurobonds. MDBs could reduce sovereign borrowing costs by as much as 500% compared to Eurobond lending simply by using their 'AAA' ratings and preferred creditor status to secure lower borrowing costs and passing these on to sovereigns.<sup>19</sup>

On a practical level, these G20 steps have arguably been successful for three reasons:

- They are mandated by the G20 but create commissions of technical experts, largely shielded from the politics and geo-politics of G20 communiqués and official processes, that can make robust and specific recommendations to specific institutions. This is particularly important given the challenges of securing agreement on G20 communiqués since Russia's invasion of Ukraine, US-China tensions and the differing views on Israel's actions in Gaza.
- They have been sustained through G20 presidencies that have carried the 'baton' and sustained political momentum as the MDBs have sought to implement their recommendations; most recently this has included a commitment from the Brazilian presidency of the G20 to review the MDB reform roadmap.<sup>20</sup>
- They have been supported by an advocacy and campaigning infrastructure. This has included the work of leading philanthropies such as the Bill and Melinda Gates Foundation, Open Society Foundations, Rockefeller Foundation, Children's Investment Fund Foundation; and non-governmental organisations and think tanks such as The ONE Campaign, Global Citizen, E3G, Centre for Global Development and ODI. It has also involved advocacy from multi-stakeholder groups such as the [Bridgetown Initiative](#) and the [Paris Pact for People and Planet](#).

This model both shows a sense of momentum and sets a precedent for an effective mechanism for G20 action on these issues in the current geo-political climate. But the volumes of finance that have been unlocked are far from the scale of need. Estimates on the annual needs on public finance for climate and development are in the range of \$1 trillion to \$2.4 trillion.<sup>21</sup>

A logical development of the MDB reform work, and a potential alternative route to addressing future debt sustainability issues, lies in a comprehensive expert review of the issues impacting the cost of capital in emerging economies, particularly Africa. Some elements of this agenda, including private capital mobilisation and a review of credit rating agency methodologies, are included in the Task Force on a

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<sup>15</sup> Inter-American Development Bank, "[Multilateral Development Banks Deepen Collaboration to Deliver as a System](#)", April 2024.

<sup>16</sup> Asian Development Bank, "Capital Adequacy Framework", <https://www.adb.org/capital-adequacy-framework>

<sup>17</sup> G20 Independent Experts Group, "[The Triple Agenda: A Roadmap for Better, Bolder and Bigger MDBs](#)", October 2023.

<sup>18</sup> G20 New Delhi Leaders' Declaration, <https://www.consilium.europa.eu/media/66739/g20-new-delhi-leaders-declaration.pdf>

<sup>19</sup> Dodd and Rivera, "The Collateral Damage of Rising Interest Rates".

<sup>20</sup> "[G20 to Review Multilateral Development Banks Reform Roadmap in October, Says Brazil](#)", Reuters, April 18, 2024.

<sup>21</sup> V Songwe, N Stern and A Bhattacharya, "[Finance for Climate Action: Scaling Up Investment for Climate and Development](#)" (London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, 2022).

Global Mobilization against Climate Change's agenda for the Brazilian G20 and could be developed further.<sup>22</sup>

## Cost of Capital Commission proposed

A Cost of Capital Commission would bring together high-level commissioners, including former finance ministers, central bank governors and private sector leaders from the finance and the regulatory community, to analyse the landscape and identify specific areas for policy reform that the G20 could mandate that key institutions such as the IMF, Bank for International Settlements and credit rating agencies could take forward.

Three eminent individuals could be identified to lead the commission – representing the G20 presidencies and nominated by Brazil, South Africa and the US to ensure buy-in and sustained action. Potential candidates could include Henrique Meirelles (Brazil, former finance minister and central banker), Trevor Manuel (South Africa, former finance minister) and Larry Summers (US, former treasury secretary). These co-chairs would then identify up to 20 highly credible commissioners representing a range of perspectives and disciplines in order to give confidence to market actors and G20 finance ministries.

The commission would be supported by a secretariat (based at a credible economic think tank or university) to do technical work and build a work plan. Philanthropic foundations could provide financial support to this work.<sup>23</sup>

An indicative timeline for the commission could be as follows:

- *September / October 2024:* Introduce the commission to the Brazilian G20 presidency and work to socialise the concept with G20 members by circulating a non-paper (which could be drafted by a relevant think tank).
- *November 2024:* Recruit co-chairs and identify secretariat (institution) to support the commission's work plan. Introduce commissioners to G20 Finance Track leads at Rio G20 Head of State Summit.
- *December 2024:* Recruit commissioners.
- *January/February 2025:* Announce commission at G20 Finance Ministers meeting.
- *April 2025:* Present update on first draft of commission at World Bank/IMF Spring meetings.
- *July 2025:* Present and publish commission report at G20 Finance Ministers meeting.

### An indicative agenda for the Cost of Capital Commission

The work plan and areas for action emerging from the commission could include the following:

**Review credit rating agencies' methodologies.** Credit ratings and a country's debt designation as 'investment grade' or 'non-investment grade/speculative' often determine the cost and volume of capital a country can raise. Critics have highlighted market concentration and bias within the credit

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<sup>22</sup> G20 Brazil, Extended outline to inform drafting of the outcome document, (Not a public document).

<sup>23</sup> Previous G20 expert groups and commissions have been supported by staff from the Centre for Global Development and the Brookings Institution.

rating methodologies of the 'big three' rating agencies: Fitch, Standard and Poor's (S&P) and Moody's. Analysis by Trading Economics shows that only 21 African countries have ratings with S&P and 28 with Moody's.<sup>24</sup> Analysis from the UNDP suggests that African countries could save up to \$74.5 billion if credit ratings were based on less subjective assessments.<sup>25</sup> Bias can also be introduced through the absence of necessary data to support statistical models.<sup>26</sup> The commission could recommend steps to reform these methodologies, including boosting transparency via enhanced regulatory requirements, public disclosures and peer review and input into rating decisions and integrating climate and nature risks. It could also put forward recommendations for how emerging market and development economies (EMDEs) could ensure that better data is generated and necessary regulatory reforms are undertaken to reduce the cost of capital.<sup>27</sup>

**Review the role of macro-prudential regulation to identify areas for reform to unlock lower-cost private capital.** The [Basel III framework](#) was designed to shore up risks in the international banking system following the 2008 global financial crisis. However, a lack of nuance in capital liquidity requirements inhibits incentives for private investors to invest in EMDEs. For example, capital requirements and risk-weight determination are often higher for EMDEs than advanced economies and would benefit from a nuanced analysis of where these risks weightings are warranted. Banks, insurance companies, pensions and other investors are constrained from investing in EMDEs by features of regulatory capital requirements and rating agency methodologies that are driving up costs and slowing down capital deployment. The commission could recommend steps to reform the Basel III regulatory framework to address these challenges.

**Scope potential for the integration of natural capital and remittance flows within debt sustainability analyses and credit ratings.** Remittance flows to low- and middle-income countries (LMICs) doubled from \$339 billion in 2010 to \$669 billion in 2023, exceeding foreign direct investment and ODA and representing over 15% of GDP for 25 LMICs and between 5-10% of GDP for an additional 34 countries.<sup>28</sup> Remittances have helped stabilise currency fluctuations and build reserves, thus mitigating debt vulnerabilities.<sup>29</sup> The inclusion of remittances in the denominator of the debt-to-export ratio in middle-income countries with large remittance receipts would improve the sovereign rating by one notch. In the case of S&P ratings, a country rated B or below can reduce borrowing costs by 100 basis points, substantially reducing the cost of capital.<sup>30</sup> Similar steps could be taken to incorporate the value of natural capital in these assessments, which could significantly alter the scope of ratings and debt sustainability analyses.

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<sup>24</sup> Trading Economics, "Credit Ratings Africa", <https://tradingeconomics.com/country-list/rating?continent=africa>.

<sup>25</sup> UNDP, "Lowering the Cost of Borrowing in Africa: The Role of Sovereign Credit Ratings", (Policy Brief, April 2023), <https://www.undp.org/africa/publications/lowering-cost-borrowing-africa-role-sovereign-credit-ratings>

<sup>26</sup> D Tennant, M Tracey and D W King, "[Sovereign Credit Rating: Evidence of Bias Against Poor Countries](#)", *The North American Journal of Economics and Finance* 51 (2020).

<sup>27</sup> Arend Kulenkampff et al., "[Sovereign Credit Ratings: Unblocking Capital Flows for Development by Upgrading the Current Rating Regime](#)", Sustainability Linked Sovereign Debt Hub, May 2024.

<sup>28</sup> Knomad, "[Leveraging Diaspora Finances for Private Capital Mobilization](#)" (Migration and Development Brief 39, World Bank Group, Washington DC, December 2023).

<sup>29</sup> C Chuku et al., "Are We Heading for Another Debt Crisis in Low-Income Countries? Debt Vulnerabilities: Today vs the pre-HIPC Era" (Working Paper 2023/079, IMF, Washington DC, 2023).

<sup>30</sup> Dilip Ratha and Sanket Mohapatra, "[Increasing the Macroeconomic Impact of Remittances on Development](#)", 2007.

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## About SAlIA

SAlIA is an independent, non-government think tank whose key strategic objectives are to make effective input into public policy, and to encourage wider and more informed debate on international affairs, with particular emphasis on African issues and concerns.

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