

CLIMATE CHANGE FINANCING AND PRIVATE SECTOR IN AFRICA

From the African Community of Practice on Managing for Development Results at the African Capacity Building Foundation (ACBF)



Case Study
N° 31

SYNOPSIS

Climate finance is increasingly playing an important role in paving the way for low-carbon and climate-resilient investments, globally and in Africa. Climate finance helps to lower the cost of investment and buffers the risks both for sovereign and non-sovereign operations. Without concessional climate finance, the private sector would likely to be unable to play a key role in tackling climate change. The additional resources, through climate finance, are important for lowering investment risks and the establishment of an enabling environment for private sector operations. The overarching objective of this paper is to provide an overview of the key climate finance instruments, challenges and opportunities, and the role of the private sector in Africa. The study is descriptive and analytical. It makes use of qualitative and quantitative approaches for data collection and analysis. The paper identified the following climate finance instruments: equity, grants, loans, guarantees, line of credit, advisory services, green bonds, and policy based loan/budget support and purchase agreement for climate finance projects. In addition, the opportunities identified include the potential to invest in green infrastructure, clean energy, and provision of green jobs and development of the green economy. Lastly, some challenges include: high capital investments requiring upfront payments, lack of bankable projects in Africa and limited capacity of the private sector to participate in climate finance.

Among the key findings: Most climate finance investments in Africa are centered on the development of clean energy investment while neglecting the interface of climate change with key sectors like agriculture, water and sanitation and transport. The paper also identifies the issue of limited capacity both human and financial as a major hindrance in preparing bankable projects coupled with weak government policies. To ensure that climate finance delivers its intended results, the paper underlines the need of accountability and tracking of climate finance resources by putting in place monitoring, reporting and verification of results systems in the recipient country.

The main recommendation: Provision of capacity building targeting project developers and investors, public sector and the civil society is necessary. Government must play its role in strengthening the enabling environment for private sector operations. If these measures are well implemented, they will lead to increase in the numbers of private sector bankable projects.

Introduction

In 1997, the Kyoto Protocol was signed at the Third Session of the Conference of Parties (COP3) at the United Nations Framework Convention on Climate Change (UNFCCC). The Kyoto Protocol introduced three market based-mechanisms,

namely: the Clean Development Mechanism (CDM), the Joint Implementation and the Emissions Trading. This paper restricts itself to addressing the CDM that was put in place with the aim of simultaneously tackling the adverse effects of climate change. The CDM was aimed at

integrating sustainable development into the poverty reduction strategies, in developing countries like those from Africa. The signing of the Kyoto Protocol also signalled the introduction of the term “climate finance” in the development landscape. Operating under the auspices of the CDM are programmes that include Reduced Emissions from Deforestation and Forest Degradation (REDD+). Under the Paris Agreement in 2015, emerged a new arrangement called the INDCs (Intended Nationally Determined Contributions) that were anticipated to become the shortest lived term in climate change, soon after the countries would have ratified the Paris Accord, possibly in 2016. The INDCs will therefore become the National Determined Contributions (INDCs).

The overarching objective of this paper is to provide an overview of the key climate finance instruments, challenges and opportunities, and the role of the private sector in Africa.

The specific objectives of this paper are to:

- Examine the main drivers of climate finance and their impacts on the private sector, poverty alleviation and green growth in Africa, and
- Assess the importance of the private sector in the climate finance architecture, and how best the sector can be engaged in leveraging climate finance in Africa?
- Provide a framework on which capacity building programs and result oriented training can be organised to address the challenges of climate financing and INDCs implementation in Africa.

The study is descriptive and analytical. It makes use of qualitative and quantitative approaches for data collection and analysis. For data collection, the study obtained data from policy documents relating to climate finance, such as Climate Scope’s 2015 Report, 2014 Joint Report on MDBs’ Climate Finance, Climate Policy

Initiative’s Global Landscape of Climate Finance 2015, United Nations Environment Program (UNEP) 2014, Demystifying Private Climate Finance and World Resource Institute’s Public Financing Instruments to Leverage Private Capital for Climate-Relevant Investments. Secondary literatures were studied and analysed. References from previous seminars, conferences and studies were also consulted.

1. Global environmental governance, climate finance and the private sector

The concept of global environmental governance was first used during the 1972 Stockholm Conference on the Human Environment, referring to self-regulation by societal actors, or private-public cooperation in the tackling of environmental problems, as stated by Betsill *et al.*, (2006). They also noted that the term also denotes a global political order that is no longer limited to nation-states, but which is characterized by raising involvement of non-state actors (e.g. private sectors, civil society organizations, and Non-Governmental Organizations) in environmental policy making and implementation.

In this regard, climate finance has been considered as an example of a new environmental governance order, which requires the participation of both the public and private sectors. Streck and Chagas (2007) noted that private actors take part in climate finance through project investment, research and technological development.

It is for this reason that Falconer and Stadelmann (2014), defined climate finance “typically as financial resources paid to cover the costs of transitioning to a low-carbon economy, and to adapt to or build resilience against current and future climate change impacts”. The term has gained prominence in climate policy discussions due to increased appreciation of the need to make use of climate finance resources. The Joint Report by Multilateral Development Banks

(MDBs) on climate finance for 2014, published in June 2015 identified the following instruments for channelling climate finance resources: equity, grants, loans, guarantees and purchase agreements for climate finance projects. Other climate finance instruments not covered by the MDBs Report include: line of credit, advisory services, technical assistance and green bonds. Since the inception of the CDM, Africa private sectors participation in climate finance has been low and faced several challenges in terms of mobilizing and utilizing financing for low carbon investments. When compared with China, India, Brazil, and Mexico, the investment flowing into Africa is very low. This assertion has been supported by the MDB's Climate Finance Report which shows that, of the total USD 28,345 million MDB climate finance flow in 2014, Sub Saharan Africa received just 15% of the total flow as against 31 % for South Asia, 17% for Latin America, etc. To support the participation of the private sector, Venugopal *et al.*, 2012, noted that governments have as responsibility to better tailor the use of public financing instruments and maximize flexibility in the use of these instruments, so as to address the internal constraints, policy and institutional barriers to private sector investment.

In its newly adopted ten-year development strategy (2013 – 2023), and its private sector development strategy (2013 - 2017), the African Development Bank (AfDB) is committed to supporting African countries in transition to low carbon development (AfDB 2013). From the report of the AfDB Advisory Group on Climate Change Finance (AGF), it emerges that under the Copenhagen Accord, developed countries pledged to provide new, additional 'Fast Start' resources of \$10 billion a year, between 2010 and 2012 and \$100 billion a year by 2020 to support climate actions in poorer countries (AfDB 2011).

In order to ensure the participation of the private sector in climate finance, the AfDB has setup the

Sustainable Energy Fund for Africa (SEFA), to support the participation of the African private sector in renewable energy investment. The African Renewable Initiative (AREI) has also been launched to widen private sector participation in clean energy investment. The AfDB is also playing a key role in promoting climate finance in Africa by: strengthening national finance to support out-reach innovation; leveraging new money from public and private sources; lowering barriers to engage private sector and other investors; bringing together stakeholders from community to global levels; and supporting new and innovative technologies, such as renewables, climate resilience mechanisms, and forest management solutions (AfDB 2015).

It is important to underscore the role of the public sector which is significant in addressing risks, improving returns and closing knowledge gaps, to incentivize private investment at scale. Some multilateral institutions providing climate finance include: the Green Climate Fund, Climate Investment Funds, Nordic Development Fund, Global Environment Facility, Adaptation Fund; and via the AfDB - the African Climate Change Fund, Sustainable Energy Fund for Africa and Agence Française de Développement, just to name a few.

2. Paris Agreement and its implications for climate finance in Africa

According to Phillips (2015), before the conclusion of the Paris Agreement on climate change, December 12, 2015, countries were obliged to prepare and submit their INDCs. In practical terms, the INDCs incorporate bottom up commitments from all nations towards the agreed objective of limiting average surface temperature increase to 2°C. INDCs are voluntary in nature, but will become binding with the ratification of the Paris Agreement and this will have the following implications for Africa (Phillips 2015):

- There will be a paradigm shift with no more Annex 1 or Non-annex 1 countries to a world where all parties have binding responsibilities. Particularly, this is reflected in the concept on INDCs, a bottom up mechanism for defining commitments. The significance of this fact is that African countries can no longer sit back and do nothing. Instead, they are expected to implement policies and measures to reduce their emissions.
- African countries have to start thinking on implementing climate finance policies because donors and private sector investors will not be lending or financing projects or programs that run contrary to a country's efforts to achieve its commitments. Donors and investors will only finance projects that satisfy a country's INDCs commitment.

INDCs will become the road-map for public and private sector funded development, and for this reason, it is vitally important that all nations take their INDCs seriously and build in, inter alia, realistic emission projections.

3. Potentials for private sector in climate finance in Africa

In its 2014 report titled 'Demystifying Private Climate Finance', UNEP noted that for the international climate committee to successfully tackle the adverse effects of climate change and move away from business-as-usual investments, climate financing is imperative. More importantly, climate finance with the participation of the private sector is necessary to catalyse paths towards low-carbon as well as climate resilient developments.

Because of the growing importance of the role played by the private sectors, the MDBs have now realized that they must involve the private sector in leveraging climate finances. Accordingly, the 2014 AfDB Climate Investment Funds report, underscores the significant role of the private sector in the new climate finance

architecture. The report acknowledges that private enterprises are uniquely positioned to contribute to climate action, through innovative emission-reducing technologies, by introducing novel business models and financial instruments which embed sustainability into business operations. The report further stated that the private sector stands- to profit from climate investments, as the demand increases for renewable energy, efficient power plants, better public transport, high quality agricultural products, and climate-resilient infrastructure. Finally, the report underscores that for the private sector in Africa, this shift carries inherent risks including project-specific risks, perceived risks and financial risks. The report also assesses the preparation of the African private sectors to embrace climate finance in the new development aid nomenclature (AfDB 2015).

The Climatescope 2015 Annual Report also noted that while the private sector has begun showing signs of getting more involved in climate finance, most of the investments in Africa were centred on the development of clean energy with over \$25bn deployed in renewables (excluding large hydro). The report noted that most investments in Africa took place in South Africa with over \$16bn invested in clean energy projects, followed by Kenya at \$4bn and Ethiopia at \$1.8bn. The report also noted the slow growth of carbon offset projects and limited development of local value chains, and the neglect of other vital sectors such as water and sanitation, agriculture, transport and urban development. However, the report acknowledges that despite the significant increase in clean energy investments, large scale solar energy investments are yet to take off outside South Africa with Rwanda boosting the largest projects with a capacity of 8.5MW. Finally, the report noted that with an estimated 1.3bn people lacking access to energy, climate finance presents a huge opportunity for the private sector for off-grid clean energy technologies,

especially small-scale solar, coupled with battery storage facility.

Another significant contribution to buttress the significance of climate finance to the private sector is by Buchner *et al.*, (2015 p.4), who stated that private sector investment in climate finance in 2014 accounted for USD 243 billion in renewable energy, with China alone accounting for 34%. They stated the reasons why China has been able to dominate private sector finance in 2014 is because of the Chinese government's ambitious target and supportive policy towards private sector investment. They urged other countries, especially in Sub Saharan Africa, to follow the example of the Chinese government to boost private's sector participation in climate finance.

Finally, Whitley *et al.*, (2014) also observed that there is a widespread acceptance that significant increases in financial resources are needed to help African countries undertake climate compatible development (CCD), and that a significant portion of such resources is expected in the form of private sector investments, wherein, public finance and incentives are needed to shape such investment. Whitley *et al.*, (2014) also noted that by using examples from two sectors in four African countries, Uganda and Namibia's energy sector and Tanzania and Zambia's agricultural sectors, they observed the following:

- To create an enabling environment for private investment in CCD requires greater support at market level and increased policy coherence within climate relevant sectors;
- The need to design interventions to mobilize private finance for CCD requires a clear understanding of the distinct roles of the finance sector, and other sources of capital for businesses and households; and
- The much needed public support to market-level information collection and

dissemination can help facilitate private finance for CCD.

4. Managing for Result in the New Climate Finance Regime

While it is important to have the necessary financing and technical assistance needed to tackle the adverse impacts of climate change in Africa, it is also necessary to ensure the effective management of climate finance resources. This is buttressed by the MDB report on Climate Finance for 2015, which states that transparency and credible information on finance flows are essential to demonstrate the effectiveness of delivery impacts on the ground. It is important to also stress that, the main aim of climate finance is to reduce climate vulnerability and promote climate resilient development in developing countries like those in Africa. Therefore, climate finance most creates a long lasting impact on the ground by helping the country build adaptive measures against climate change. For this to be effective, good measures are needed to monitor and evaluate the impact of climate change finances. In this regards, there is the need to put in place social and climate change safeguards, compliance and tracking mechanisms that will have as mandate to verify the development impact of climate finance. Managing for results is very important in climate change financing since the resources are mainly from external bodies, therefore it is important to account for these resources by putting into place the necessary mechanisms to track and ensure they are impact driven.

However, despite its importance, managing for results for climate finance tracking, reporting and verification are not well developed in Africa. Gamma and Nigel (2011), identified some of the challenges affecting its implementation; that there is no agreed national framework for tracking and monitoring development results in many Africa countries. They also stated that reporting on climate change remains externally

driven and some donors continue to provide climate change financing off-budget.

5. Suggested Policy Actions

Even though Africa contributes the least in terms of global greenhouse emissions, the continent is still blessed with a lot of potentials to attract climate finance. However, there exists a significant bottleneck in unlocking Africa's response to climate change and the development of viable projects that meet the viability and bankability test of project investors. The challenges experienced by project developers require the establishment of an innovative and collective approach to addressing the issues.

In order to facilitate their participation in low carbon developments in Africa, Whitley *et al.*, (2014) have suggested some significant policy recommendations to boost private sector participation. These include: The need to enhance tracking efforts to further improve the transparency, comprehension, and consistency in accounting approaches; getting domestic investment policy and support frameworks' right. There is the need for a clear understanding of where investments take place and to identify the underlying drivers and then overcome the barriers to climate-relevant private investment; the need to promote innovation that will help to develop the financial instruments that should meet the needs of investors; the need to enhance the integration of climate change considerations into the financial system of the country; and the need to enhance the integration of environmental, social, and governance (ESG) factors in investment decision-making processes, which will help investors to better understand risks and know how to mitigate them.

Besides the measures stated above, other policies include: African governments should work with the international community to better utilize climate finance, to prepare bankable projects and to build local capacity to implement their INDCs commitment. Putting a price on

greenhouse gas emissions, either through taxation or the implementation of emissions trading schemes at the domestic and later at regional levels, or a combination of both, will help promote climate finance. Other policies and measures which should be rapidly deployed include the removal of subsidies, strengthening of the role of private sector in climate finance, promotion of legislation in favor of climate compatible developments, and strengthening domestic resource mobilization. Internal resources mobilization is important to generate revenue from within the country, without depending on external sources. The need to provide capacity development to project developers and investors on climate finance, including market-based approaches for sustainable development is very imperative. INDC's training is also important for national government officials and local stakeholders in order to take ownership of their INDCs commitments. The proposed capacity building trainings should be able to facilitate and deliver high quality, innovative training and enable sharing of knowledge on best practices. The training should be tailored to meet public and private sector capacity needs, demand and readiness.

Payment for ecosystem approaches and measures should be encouraged in order to promote the integration of natural resource management that will improve the livelihoods of local communities which find it difficult accessing climate finance resources.

To ensure that climate finance attained its objective of tackling the adverse effects of climate change in Africa, mechanisms must be put in place to monitor and track the effectiveness of climate change financing. Integrating climate change policies into the country's economic planning is very important to derive the maximum results from climate change finance. One prominent measure is the AfDB

Environmental and social Safeguard framework which is being used to mainstream social and environmental considerations in its operations. Still within the AfDB, there is also the Climate Safeguards System (CSS) which supports implementation of 'climate safeguards' during diligence processes. Gamma and Nigel 2011 also recommends that embedding climate change into ministries performance contract will reinforce climate financing as a cross-cutting issue and encourage bottom up reporting from the ministry level. It is therefore critical that investments are made to increase government capacity for reporting on climate change, particularly at the individual ministry level.

6. Conclusions

While huge amount of money has been pumped into the continent through various climate finance initiatives to tackle the adverse effects of climate change, much still needs to be done. At the national level, African governments have been participating in various climate finance initiatives, such as CDM, REDD+, Nationally Appropriate Mitigation Actions (NAMAs) and recently the INDCs and MDBs through project operations. With the ratification of the eminent Paris Agreement, the private sector in Africa is expected to play an important role to enable national governments to meet their INDCs commitment. For the private sector to be able to benefit from climate finance funding, they need to design good projects that will attract the much needed investments or funding. On the other hand, African governments have to demonstrate their commitments to supporting the private sector. The responsibility of each government is to enact policies and provide measures to support the flow of climate finance and create an enabling environment for the private sector.

It is important to note that investing in low carbon development in Africa is a huge investment opportunity that will not be successful without concessional climate finance

from the international community. Climate finance goes beyond the energy sector and presents huge opportunities to spur the much needed financing to promote sustainable economic development (green growth) in Africa. These opportunities include: the development of low-carbon transport systems, such as railways and urban metros, low-emission buildings, both new constructions and retrofitted existing buildings and the benefits through payments for ecosystem services.

Capacity development to enable private sector and civil society to have access to climate finance is very important in African. For the private sector and civil society to succeed in playing a significant role in tackling climate change they need to acquire enough capacity and skills to bridge knowledge gaps. They need to be able to design and implement bankable projects. As the Paris Agreement becomes eminent, it is also important that public and private sectors including the civil society acquire the necessary skills that will enable them to claim, implement and take ownership of their INDCs commitments

The effectiveness of the above measures, if implemented will achieve the necessary national outcomes. It is also important that capacity building programs and the recommended policy actions are carefully monitored starting from changes in knowledge and attitude before and immediately after each training. The feedback that will be obtained from such trainings will be useful to refine and fine tune the training curriculum and approaches to capacity building in climate change and climate finance.

While waiting for more climate finance resources to start flowing from the Paris Agreement, it is important to evaluate the developmental impacts and the contribution of climate finance through the CDM in promoting sustainable development in Africa. It is also important to assess why the participation of the Private

sectors within the CDM was below expectation. This is important in order to avoid the same mistakes made when the Paris Agreement becomes operational. Lastly, effective monitoring, reporting and verification are very important tools to be employed in order to measure the developmental impacts of climate finance in Africa.

References

- African Development Bank 2011: **Report of the Advisory Group on Climate Finance: Implications and Next Step for Africa**
- African Development Bank 2013: **At the Center of Africa's Transformation Strategy for 2013–2022**
- African Development Bank 2015: **Financing Change in Africa: AfDB CIF Annual Report 2014**
- African Development Bank 2015: **Spearheading Change: The AfDB Role in Financing a Climate-Smart Africa**
- Betsill MM, Hochstetler K, Stevis D 2006: **Palgrave Advances in International Environmental Politics**. Published by Palgrave Macmillan, New York
- Buchner k. Barbara, Trabacchi Chiara, Mazza Federico, Abramskiehn Dario & Wang David 2015: **Global Landscape of Climate Finance 2015**. Climate Policy Initiative
- ClimateScope 2015: **The Clean energy Country Competitive Index**
- Falconer Angela and Stadelmann Martin 2014: **What is climate finance? Definitions to improve tracking and scale up climate finance. Climate Policy Initiative**
- Gemma Norrington-Davies and Nigel Thornton 2011: **Climate Change Financing and Aid Effectiveness: Kenya Case Study, March 2011**. Agulhas Applied Knowledge
- Phillips Gareth 2015: **Climate Change in Africa: A race against time**. Blog Series
- Shelagh Whitley, Granoff Ilmi, Chiofalo Emilo, Halimanjaya Aidy & Sam Pickard 2014: **Private climate finance: Mapping Incentives and Investments in Sub Saharan Africa**. Overseas Development Institute Working Paper on Sharing Policy for Development.
- Streck Charlotte and Chagas B. Thiago 2007: **The Future of the CDM in a Post-Kyoto World**. CCLR 1
- United Nations Environment Programme, 2014: **Demystifying Private Climate Finance**. UNEP Finance Initiative Changing finance, financing change
- Venugopal Shally, Srivastava Aman, Polycarp Clifford, and Taylor Emily 2012: **Public Financing Instruments to Leverage Private Capital for Climate-Relevant Investment: Focus On Multilateral Agencies**. World Resource Institute



Acknowledgement

This knowledge series intends to summarize good practices and key policy findings on managing for development results (MfDR). African Community of Practice (AfCoP) knowledge products are widely disseminated and are available on the website of the Africa for Results initiative, at: www.afrik4r.org/page/resources.

This AfCoP-MfDR knowledge product is a joint work by the African Capacity Building Foundation (ACBF) and the African Development Bank (AfDB). This is one of the knowledge products produced by the ACBF under the leadership of its Executive Secretary, Professor Emmanuel Nnadozie.

The product was prepared by a team led by the ACBF's Knowledge, Monitoring, and Evaluation Department (KME), under the overall supervision of its Director, Dr. Thomas Munthali. In the KME Department, Ms. Aimtonga Makawia coordinated and managed the production of the knowledge product while Dr. Barassou Diawara, Mr. Kwabena Boakye, Ms. Anne Francois, Mr Frejus Thoto, and other colleagues provided support with initial reviews of the manuscripts. Special thanks to colleagues from other departments of the Foundation who also supported and contributed to this paper's production. The ACBF is grateful to the AfDB for helping produce this case study under grant number 2100150023544.

The ACBF is also immensely grateful to Mr. Njume Gerald Esambe, the main contributor, for sharing the research work contributing to the development of this publication. We also thank independent reviewers whose insightful external reviews enriched this knowledge product. The Foundation also wishes to express its appreciation to AfCoP members, ACBF partner institutions, and all individuals who provided inputs critical to completing this product. The views and opinions expressed in this publication do not necessarily reflect the official position of the ACBF, its Board of Governors, its Executive Board, or that of the AfDB management nor its board.