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Breaking Financing Barriers for Just Climate Transition in Africa

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Executive summary

September 2023 was the month of summits, and these summits held monumental importance for the African continent: The Africa Climate Summit, the United Nations Climate Ambition Summit, the SDG Summit, and the G20 Leaders' Summit. These summits marked a pivotal moment to reflect on the progress made and on the unfinished business in tackling and averting the impacts of climate change.

One challenge persists—the barriers to financing climate projects in Africa. How can climate action projects thrive in the face of constrained financing? What barriers hinder the financing of a just and equitable transition in Africa? And what practical interventions can unlock climate finance? These questions become even more significant at a time when many countries are dealing with elevated debt levels and strained public finances amidst multiple crises.

The complementarity between climate action and sustainable development is indisputable. The inseparable link between sustainable economic growth and climate action is undeniable—they must be pursued concurrently, or neither will happen. Addressing climate change not only safeguards the environment but also directly influences poverty eradication (SDG 1), access to clean water and sanitation (SDG 6), affordable and clean energy (SDG 7), sustainable cities and communities (SDG 11), responsible consumption and production (SDG 12), life on land and below water (SDGs 14 and 15), infrastructure (SDG 9), reduced inequalities (SDG 10), decent work and economic growth (SDG 8), and zero hunger (SDG 2).

Financing barriers reveal that the global climate finance system is inefficient, insufficient, and unfair. Strained national budgets and unsustainable debt levels are intertwined with unsupportive policy frameworks, inconsistent regulation, and insufficient private sector engagement. Additionally,

heightened perceptions of investment risk in Africa, perceived and real foreign currency risks, the complexity of existing international climate finance mechanisms, and data limitations, collectively curtail climate-aligned investments.

The challenge of climate financing in Africa is not due to a lack of a pipeline of investable projects. The continent is rife with investable projects. In 2022, the UN High-Level Champions held regional forums showcasing more than 100 shovel-ready projects in African and other developing countries. There is a real need to champion the matching of project developers with public and private financiers.

There is an urgent need for systemic reforms to the international financial architecture (IFA). The IFA has long been plagued by structural deficiencies, and reforms are needed to make the global financial system truly global and representative for emerging markets and developing economies (EMDEs). The Sharm El-Sheikh Implementation Plan called on multilateral development banks (MDBs) and international financial institutions to reform their practices and priorities to make climate finance more accessible.

Recent developments have underscored the urgent need for IFA reforms. The Bridgetown Initiative recently outlined specific reforms by UN member states, G20 creditors, IMF, World Bank, MDBs, and other public, multilateral, and private creditors. The Summit for a New Global Financial Pact in Paris called for renewed relations between the Global North and the South to facilitate the access of vulnerable countries to financing. The Marrakesh Declaration, signed by ministers of finance in Africa, also explicitly outlined "An African Agenda for Global Financial Architecture '' and insisted on a global financial architecture that includes Africa not only as a beneficiary but also as a contributor of ideas, innovations, and investment possibilities.

In light of this, we propose five interventions to unlock financing for climate transition in Africa:

1. **Suspend and reduce debt for low- and middle-income countries, including the use of innovative debt swaps and revision of SDRs:** We call for the suspension and reduction of debt for low- and middle-income countries (LMICs). G20 creditor countries should accelerate debt relief and cancellations, and MDBs urgently need to implement the Climate Resilient Debt Clauses. The clauses were developed in response to the Sustainable Debt Coalition created at COP27 in Egypt. Equally, we endorse the debt proposals of the Bridgetown Initiative. Additionally, we propose the use of debt-for-nature or -climate swaps to strengthen recipient countries, allowing them to repay their debts by investing in nature regeneration and climate action. We also call for the modification of Special Drawing Rights (SDRs) as fundamental for sustainable and adept debt management in LMICs.
2. **Extend below-market-rate or concessional capital to EMDEs:** We propose that MDBs, including the World Bank, provide LMICs with a 1 percent interest rate, a 10-year grace period, and a 20-year repayment term for financing projects that boost resilience to climate

change. These concessional terms need to be supported by the climate finance contributions of advanced economies. Furthermore, we urge governments and development agencies to establish substantial and adaptable pools of concessional capital to support smooth and transparent financing of climate projects, in line with countries' Nationally Determined Contributions (NDCs).

3. **Credit enhancement and credit guarantee schemes to incentivize private sector participation:** We call for credit enhancement and guarantee schemes that can provide credit assurances and effectively offer project de-risking, encouraging private investors. Credit assurances enhance investor confidence, driving private sector involvement through co-financing and risk-sharing. In line with this proposal, we endorse the call by the Bridgetown Initiative for public, multilateral, and private creditors to refinance high-interest, short-term debt with credit guarantees and longer maturities.
4. **Foreign exchange (FX) guarantee mechanism:** We call for the establishment of a fund that helps private investors mitigate foreign exchange risks by providing cost-effective currency hedges for climate action investments in Africa. This Multi-Partner Trust Fund (MPTF) would help reduce the real and perceived risk of investing in climate projects amidst currency volatility. For effective risk management of capital-intensive climate projects, an FX guarantee mechanism is vital, as currency risk can sometimes overshadow macro-risk in some economies. On a global scale, currency risks are entrenched in international investments, especially in EMDEs with fluctuating exchange rates.
5. **A turbocharger facility for climate action projects and entrepreneurs in Africa:** We call for the creation of a turbocharger facility for projects and entrepreneurs running project preparation programs on the continent. This is especially important for projects that can regenerate nature and help communities adapt to climate change impacts. Currently, existing project preparation facilities are still too small, hard to access, and largely disconnected from follow-on funding and de-risking mechanisms. This facility does not need to be a brand-new fund with cumbersome infrastructure; it could be set up by existing funders and investment instruments already operating in Africa. States can support such projects in their climate and development plans, and the private sector can also add value by sharing early feedback and expertise with project developers.

In conclusion, breaking barriers to climate financing requires bold interventions at a systemic level. The five financial proposals outlined above can help African countries to mobilize substantial climate investments. The goal is to finance a just and equitable climate transition that spans across Africa; not one that is restricted to just a handful of countries deemed "investable." Achieving this transformative agenda requires collaboration at scale. This transformation therefore demands that various stakeholders, including governments, the private sector, multilateral institutions, and other international organizations, are steadfast partners.

Introduction and background

September 2023 was the month of monumental summits for the African continent: the Africa Climate Summit, the United Nations Climate Ambition Summit, the SDG Summit, and the G20 Leaders' Summit. These summits were a pivotal moment to reflect on the progress made on climate action but also on the huge unfinished business in tackling and averting the impacts of climate change. The complementarity between climate action and sustainable development has also taken centre stage in the last year across many global platforms. There is uncontested evidence that climate and action and economic development must be realized together or neither will happen.

Within this context, one very important and equally salient issue in Africa is the persistent challenge of climate action financing. How can vital climate action projects be funded to promote development amidst tight financing constraints? What forms of financing barriers exist on the continent? And what actionable ideas and interventions can be taken to address climate action financing? This issue continues to be even more relevant post-pandemic and at this midpoint of the 2030 Agenda since the Paris Agreement in 2015.

This paper seeks to elaborate keenly that climate action is a sustainable development imperative. It will do so through a discussion of the climate action imperative in Africa and make a clear linkage between climate action and the Sustainable Development Goals (SDGs). Thereafter, it will give an overview of Africa's climate finance landscape. Subsequent sections will dissect the various financing barriers and illuminate financing opportunities by proposing actionable ideas and interventions. While at it, the paper will incorporate examples of success stories of climate action financing and propose a tangible set of quick wins.

The climate action imperative in Africa

Many African countries find themselves choosing between financing projects for national SDG goals and projects for sustainability and climate action. At the core is constrained fiscal resources and national budgets. Further, the threat of climate change in Africa is aggravated by these fiscal constraints. In 2022, Africa's collective public debt reached US$ 1.8 trillion, marking a 183 percent increase since 2010. This is according to UN Global Crisis Response Group calculations, based on IMF World Economic Outlook 2023 (IMF, 2023a). The Regional Economic Outlook reported the sub-Saharan Africa public debt-to-GDP ratio at 56 percent (IMF, 2023b). In some economies, debt servicing now exceeds recurrent expenses, hampering development spending. The escalating consequences of climate change on LMICs have led to a damaging cycle of increasing debt. These nations, already facing the challenges of climate change, are forced to accumulate additional debt for recovery.

The trust deficit between the Global North and Global South is alarmingly high. For example, of the climate finance pledged during the Paris Agreement, approximately 75 percent is not yet deployed or is misdirected. This is according to the director of the Blended Finance Taskforce, Katherine

Stodulka, as quoted in ImpactAlpha (2023). This trust factor alone is complicating efforts to forge fresh financing agreements. This message reverberated widely during the recent Summit for a New Global Financing Pact held in Paris. This notwithstanding, Africa is well endowed with vast renewable energy potential and critical mineral deposits that will be key to substantially advancing sustainable socio-economic prosperity and decent lives for Africa's populations, while simultaneously advancing global climate objectives not only in the region but also globally.

With global surface temperatures already reaching 1.1°C above pre-industrial levels, and the IPCC AR6 alarming findings that Africa is warming faster than the global average, causing climate-induced reduced agricultural productivity by 34 percent, increased threats to water and food security (IPCC, 2023). The window of opportunity is narrowing to limit the rise to 1.5°C, and to urgently adapt to the devastating climate impacts on lives, livelihoods and ecosystems on which they depend. Policies put into effect by the end of 2020 are anticipated to lead to elevated global GHG emissions in 2030 compared to emissions levels suggested by Nationally Determined Contributions (NDCs) (IPCC, 2023).

Furthermore, the scale of adaptation finance in the continent does not correspond to the urgency to adapt and build long-term resilience in Africa. The Africa NDC Hub (2021) projected Africa's adaptation costs to be in the range of $259 billion to $407 billion for the period 2020 to 2030. This represents an annual investment need of $26 billion to $41 billion. Africa's Adaptation Gap Report 2023 indicated that even if we shifted to an emissions pathway that limits warming below 2°C, the annual adaptation costs would be around $35 billion by 2050 (UNEP, 2023). Despite this magnitude of costs, the project pipeline necessary to close the widening adaptation finance and implementation gaps are met with unfulfilled adaptation finance support promises. In the absence of low-cost finance availability and policy enhancements, global warming could reach 3.2°C by 2100 and numerous adaptation and resilience solutions to manage the accelerating climate impacts and risks (IPCC, 2023). It is therefore imperative that climate transitions in Africa address, at their core, sustainable financing, just energy transition, and closing the adaptation gap towards building long-term resilience.

Climate change is universal, but its harshest repercussions fall on mostly vulnerable communities. Ignoring this only amplifies the conundrum. Emerging markets and developing economies (EMDEs) are the most significantly affected by rapid climate change as they face disproportionate physical climate hazards, development constraints, and demographic that include many vulnerable groups like small-scale food producers and low-income households. Additionally, a recent Brookings article (Kharas & Rivard, 2023) reported that developing countries could contribute to over half of the global annual GHG emissions by 2030, even after excluding China, underscoring the potential for a steep rise in compounded exposure in the upcoming years.

By grasping the depth of Africa's climate predicament, we can underscore the importance of addressing financing barriers as a basis for implementing practical interventions to surmount the financing barriers.

Finance is a linchpin in overcoming the challenges of building low-emission and climate-resilient communities. This significance is underscored by the fact that climate action stands as a critical element in realizing sustainable development and eliminating poverty. The requisite financing scale for climate action projects is colossal. As the global macro-environment worsens, risk perception for capital investments is increasing, resulting in delayed investment and an inflated cost of capital in many EMDEs. Other factors, like currency risks and limited investment guarantees and de-risking options, further elevate financing barriers in Africa.

The role of the private sector in financing climate action in Africa cannot be overstated. Encouragingly, a significant chunk of the financing gap could emanate from the private sector. According to the Blended Finance Taskforce (2023), on average, MDBs mobilise less than 30 cents of private capital for every public dollar spent on climate. Since the signing of the Paris Agreement, the private sector has been instrumental in backing climate endeavours, including banks that are members of the Glasgow Financial Alliance for Net Zero coalition. This demonstrates the private sector's growing importance in achieving climate goals. However, this private finance has thus far not been incentivized to the extent needed and remains almost exclusively focused on emission reduction projects where a clear business model is ensuring a return on investment. Adaptation and resilience finance still lags far behind and will therefore continue to need creative thinking if we are to address the urgent adaptation needs of African countries.

That said, it's worth noting that the private sector is not a substitute for public financing from developing countries, nor a replacement for commitments made by developed nations. Developing countries must uphold their obligations and commitments, and private capital should not be seen as filling the gaps left by unfulfilled government promises. Similarly, for developed countries, integration of private investment should not replace their commitments like the pledge to mobilize $100 billion annually by 2020 and continuing through 2025 to strengthen climate action in developing nations. Rather, private investments ought to complement these efforts. Furthermore, it is necessary to incentivize just and equitable transitions across all African countries, ensuring that private sector finance and investment are not confined to only a handful of African nations.

Additionally, multilateral institutions, including MDBs, development finance institutions, development agencies, and global climate funds, are going to be critical levers of unlocking finance. Both the quality and quantity of climate financing by these institutions will matter for successful outcomes, including the coordination of the institutions in the regions to avoid duplicity on climate action projects where collaboration would be more effective and synergistic.

Consequently, tied to the role of the private sector and multilateral institutions, is recognising that EMDEs are rife with climate investment opportunities. However, it's equally important to acknowledge that Africa requires substantial support that might not be immediately "profitable" or revenue-generating, especially with regard to adaptation. Therefore, the imperative of achieving a fair and equitable transition should not solely hinge on what is deemed commercially lucrative.

While credit enhancements and guarantees have the potential to mobilize significant private capital, they are currently highly underutilized in climate financing. Therefore, there is a need to include a structural element of credit enhancements and guarantees to pipeline development of climate action projects and project preparation facilities. A demand-driven and systemic holistic approach is required for designing and deploying catalytic capital and credit enhancement. This holistic approach ensures that all aspects of project origination and financing are addressed.

Below-market-rate capital terms and scarce concessional funding should also be used strategically to de-risk critical infrastructure and support just transition costs.

Recent developments have highlighted the need for urgent action and systemic reforms to the international financial architecture (IFA). The IFA, which has long been plagued by structural deficiencies, is being called for reform through initiatives such as the Sharm El-Sheikh Implementation Plan, the Bridgetown Initiative, and the Marrakech Declaration. The Declaration, signed by ministers of finance in Africa, has also explicitly outlined "An African Agenda for Global Financial Architecture '' and insisted on a global financial architecture that includes Africa not only as a beneficiary but also as a contributor of ideas, innovations, and investment possibilities. To quote the UN Secretary-General António Guterres during the week of the BRICS Summit, *"Africa is underrepresented in the global financial architecture, just as it lacks a permanent seat on the Security Council. The world has changed. Global governance must change with it. We need reforms to make global frameworks truly universal & representative of today's world."*

More recently, during the Africa Climate Summit convened by the African Union and held in Nairobi, African heads of state and government adopted The African Leaders Nairobi Declaration on Climate Change and Call to Action. The Declaration explicitly called for *"acceleration of the on-going initiatives to reform the multilateral financial system and global financial architecture including the Bridgetown Initiative, the Accra-Marrakech Agenda, the UN Secretary General's SDG Stimulus Proposal and the Paris Summit for a New Global Financing Pact."* Just like the Bridgetown Initiative (whose details follow below), this continental Declaration urged for MDB reforms, revisions to the SDR liquidity mechanism, disaster suspension clauses, debt pause clauses, scaling up concessional finance, enhancement to the G20 Common Framework for Debt Treatments, and the operationalisation of the Loss and Damage Fund established at COP27. The ongoing push for reforming the international financial architecture cannot be ignored or wished away.

The Bridgetown Initiative outlines key actions to address current deficiencies through the following measures:

1. Immediate liquidity support, involving UN member states and the IMF.
2. Restoration of debt sustainability, by G20 countries, the IMF, and other creditors.
3. Mobilization of over $1.5 trillion in private sector investment for green and just transformations, facilitated by the IMF and MDBs.
4. Increase of official sector development lending by $500 billion annually for SDGs, involving the G20, World Bank shareholders, MDBs, and the IMF.
5. Aligning the multilateral trading system with the green and just transformation, and reform of governance and operations of international financial institutions

Some specific actions under the Initiative include:

For UN Member States:

- Accelerating the redirection of $100 billion of Special Drawing Rights (SDRs) to the Poverty Reduction and Growth Trust and Resilience & Sustainability Trust.
- Establishing new international resources (whether taxes, charges, or other sources) to fund the UNFCCC Loss and Damage Fund at a yearly level of $100 billion.

For G20 Creditor Countries (either through the Common Framework for Debt Treatments or otherwise):

- Redesigning of the Common Framework for Debt Treatments to accelerate debt relief and cancellation, establish clear timelines, employ debt service standstills, and permit debt-distressed middle-income nations to access the framework.

For public, multilateral, and private creditors:

- Adoption of zero-cost, net-present-value neutral natural disaster clauses within lending instruments to enhance shock absorption.
- Refinancing high-interest and short-term debt with credit guarantees and extended maturities is recommended.

For the IMF:

- Temporary suspension of surcharges for 2–3 years and restoration of pandemic-era enhanced access limits for the Rapid Credit Facility and Rapid Financing Instruments.
- Encouragement of consistent restructuring of unsustainable private debt through IMF programs, guided by locally driven fiscal sustainability plans.
- Refinement of Debt Sustainability Analysis, with adjustments to assign lower weight to debt resulting from future savings-generating investments.

For MDBs and IMF:

- Reduction of excessive macro-risk premia on developing countries, providing $100 billion annually in foreign exchange guarantees for just green transition investments.
- Expansion of project preparation support, risk mitigation tools, blended finance, and viability gap funding to bolster the pipeline of feasible development and climate projects.

For the G20, World Bank shareholders, Multilateral Development Banks, and IMF:

- Full implementation of Capital Adequacy Framework Review recommendations, including callable capital and SDR utilization.
- Allocation of an extra $100 billion in paid-in capital contributions to MDBs, with priority given to the African Development Bank by September 2023.
- Scaling up of IDA balance sheet leverage, complete funding of the Crisis Response Window ($6 billion) by end-2023, and phased increase of IDA to $279 billion in IDA 22.
- Elevation of access limits for the Poverty Reduction and Growth Trust and Resilience & Sustainability Trust.
- Transition from "GDP per capita" as the sole criterion for funding eligibility, incorporating vulnerability considerations.
- Provision of low-cost, extended-duration (50-year) loans to vulnerable countries for investments in climate resilience, pandemic preparedness, food and water security, renewable energy access, digital inclusion, and other resilience-enhancing efforts.

Within the context of international trade, addressing climate change through trade barriers is a significant concern for member countries. As emphasized by the recent BRICS declaration, strategies aimed at combating climate change and biodiversity depletion should align with World Trade Organization (WTO) guidelines, refraining from arbitrary or unfair discrimination and circumventing concealed restrictions on global trade. The implementation of such measures should be rooted in the principle of common but differentiated responsibilities and respective capabilities, thereby accounting for the diverse array of national contexts. Within this context, any trade-distorting practices that lack WTO compliance risk amplifying trade obstacles and disproportionately shifting the burden of addressing climate change and biodiversity loss onto BRICS members and other developing nations. Thus, any efforts to ensure just and equitable climate transitions should also safeguard global trade interests of African economies and other developing regions.

Amidst the calls for reforms, there are several positive developments indicating progress towards climate resilience and sustainable development in Africa. The African Risk Capacity (ARC) Group, for instance, offers innovative solutions like parametric insurance to cover disaster-related risks across the continent. It was established under the African Union and, in 2021, paid out nearly $60 million in claims related to severe weather incidents. Since 2014, ARC has issued 62 policies, providing combined coverage of $720 million to safeguard 72 million individuals in Africa (ARC 2022). For example, when Madagascar experienced the destructive impact of Intense Tropical Cyclone Batsirai, ARC facilitated an insurance payout of $10.7 million to the country's government.

Additionally, the recent Summit for a New Global Financing Pact held in Paris saw significant announcements. The IMF announced that it had reached its target of reallocating $100 billion of unused SDRs from countries with strong reserve positions to more vulnerable countries. The reallocation of SDRs can help unlock additional liquidity for developing countries, enabling them to finance climate adaptation and mitigation measures. At the Summit, countries like Senegal secured a $2.7 billion deal for clean energy investment from developed nations, while Zambia locked in a $6.3 billion debt restructuring agreement.

While these recent developments are encouraging, there is still much unfinished business to address. These developments demonstrate both the challenges and opportunities ahead. It is therefore imperative that the array of climate summits in September and the upcoming UN COP28 conference in November provide platforms to discuss and advance climate financing for Africa. Crucially, these events should focus on building upon the progress made thus far and identifying further opportunities for collaboration, innovative financing mechanisms, and policy reforms. Further, these summits need to be cognizant of the importance of concessionality since African countries already suffer from a heavy debt burden compounded by the fact that the cost of borrowing for these countries is much higher than it is for richer, developed countries. According to the Jubilee Debt Campaign (2021), 34 of the world's poorest countries spend five times more on debt than coping with the impact of climate change and reducing carbon emissions.

Stakeholders, including governments, international organizations, and the private sector, must collaborate to tackle these challenges and ensure that climate financing reaches those who need it the most. Addressing the structural deficiencies of the existing financial architecture, mobilizing resources, and promoting systemic reforms will allow us to overcome the financial barriers and drive sustainable climate transitions in Africa.

The complementarity between climate finance and the SDGs

Climate finance is paramount for the realization of the SDGs. Addressing climate change not only safeguards the environment but also directly influences poverty eradication (SDG 1), access to clean water and sanitation (SDG 6), affordable and clean energy (SDG 7), sustainable cities and communities (SDG 11), responsible consumption and production (SDG 12), life on land and below water (SDGs 14 and 15), infrastructure (SDG 9), reduced inequalities (SDG 10), decent work and economic growth (SDG 8), and zero hunger (SDG 2).

In summary, building climate resilience is foundational for long-term development, and climate action financing is a catalytic tool to propel the SDGs across these interconnected goals. To harness the synergy between climate finance and SDGs, a collective mobilization of resources is essential across different parties, and national sustainability roadmaps should explicitly include climate action plans, hence weaving climate priorities into national developmental frameworks.

The climate finance landscape in Africa: NDCs and financial flows

African nations have delineated their climate finance needs via their NDCs. To gauge the efficacy and transparency of Africa's climate finance, tracking financial flows is indispensable.

A yawning funding gap, estimated at $2.8 trillion between 2020 and 2030 (CPI, 2022), challenges Africa's climate finance aspirations to implement its NDCs under the Paris Agreement, covering merely a third of the region's overarching needs. Bridging this chasm demands inventive solutions and an expanded palette of financing modalities, alongside intensified partnerships between developed and developing nations to ensure robust financial support for climate transitions.

Regional financial institutions like the African Development Bank (AfDB) and the African Export–Import Bank (Afreximbank) are going to play an even more important role in orchestrating and executing climate finance across the continent.

Simply put, for African economies to achieve their climate objectives, the financial flows must speak to the NDCs and the other transition costs, otherwise there is a disconnect. Secondly, amplifying private sector involvement will be critical for bridging the financing gap. Additionally, attracting the finance needed calls for innovative mechanisms like debt restructuring and leveraging regional entities like the AfDB and Afreximbank. This lays the groundwork for the much needed and urgent green economic metamorphosis in Africa.

Opportunities for just and equitable climate transition financing in Africa

The landscape of Africa brims with myriad prospects for climate transition financing. African nations can and should showcase their capacity as climate investment hubs for both domestic and external capital.

The proliferation of infrastructure projects in Africa highlights the region's potential for investment. For instance, at the sidelines of the African Development Bank Group's 2023 Annual Meetings, the Africa Investment Forum presented an update on its current project pipeline (AfDB, 2023). This pipeline consists of 90 deals with a total value of $62.9 billion, categorized as either in the capital raise phase or the bankability phase. During the Forum, investors had the opportunity to explore a showcase featuring four renewable energy and sustainability projects, collectively valued at nearly $1.5 billion. Such investments in renewable energy enable recipient nations to build their energy capacity with minimal emission footprint and facilitate their transition to clean energy technologies.

This makes it a timely investment given the escalating energy demands of a rapidly growing population and the exponential growth and urbanisation of African cities.

Climate-resilient infrastructure will be key to Africa's transition equation and public-private partnerships are going to be key in financing mega-projects characteristic of infrastructural investment. This is a natural choice for tapping private capital to buttress public investments.

Current instruments, like green bonds and climate funds, augment opportunities for climate financing. Green bonds, for instance, enable governments and private entities to mobilize capital explicitly for green projects.

Barriers to financing climate action projects in Africa

The preceding discussion has already explored various financing challenges and opportunities associated with climate transitions in Africa, with a particular emphasis on the difficulty of mobilizing capital for climate action projects. The barriers to financing climate action projects in the region encompass several key issues: inadequacy of public finance and national budgets, unsustainable debt burdens, policy obstacles and a lack of regulatory incentives, perceived or inadequate risk-adjusted returns, and the complexity of international climate finance mechanisms, as well as perceived and actual foreign currency risk. Additionally, there is an underutilized potential for private sector engagement.

This section aims to provide a brief discussion of these barriers. The section that follows will focus on exploring practical interventions to some of these barriers—the central focus of this paper.

1. **Inadequacy of Public Finance and National Budgets:** Constrained national budgets limit governments' ability to allocate sufficient resources toward climate mitigation, adaptation, and resilience. Competing fiscal priorities such as health and education expenditures amidst narrow budgets make it difficult to fund climate-aligned development. Some countries will have to spend up to five times more on climate adaptation than on healthcare (UNEP, 2022). In some nations, this is compounded by political instability that can further hinder mobilization and deployment of climate finance. Also, the destruction of critical climate-resilient infrastructure during political turmoil increases the cost of climate transition.
2. **Unsustainable Debt:** Many nations grapple with the burden of unsustainable debt, complicating investments in climate action. This is a recurrent theme in the global call for reforming the global financial system and the relationship with multilateral creditors. The Sub-Saharan Africa region's public debt-to-GDP ratio now stands at 56 percent (IMF, 2023b), with debt servicing surpassing recurrent expenses in some economies, leaving little to no room for climate financing from public funds.

3. **Policy Barriers and Lack of Regulatory Incentives:** Inconsistent and uncertain policy and regulatory frameworks discourage investments in climate projects. This complexity, coupled with governance issues like corruption, heighten due diligence requirements and raises perceived risks, deterring investors. Optimal policies and regulations are critical for incentivising capital investments. Aligning local strategies with international climate commitments ensures policy coherence and promotes an investment-friendly atmosphere.
4. **Perceived/Inadequate Risk-Adjusted Returns:** Perception of high risks and transaction costs in African markets presents significant challenges for investors. Sometimes, this narrative is more about perceived risk than the actual level of risk. For instance, in some African countries, limited access to capital markets is due to credit rating agencies lacking local knowledge and data needed to provide a fair credit assessment and rating score. This, in turn, heightens the perceived risk by potential investors. Similarly, there's a widespread perception of limited local market mechanisms and financial intermediaries available for climate action projects in Africa. Overall, the heightened investment risk (real or perceived) leads to higher capital costs and limits access to cost-effective financing.
5. **Complexity of International Climate Finance Mechanisms:** Many African policymakers perceive international climate finance mechanisms as needlessly intricate, an issue linked to the global calls to reform the structural inadequacies of the IFA. This is further complicated by the political intrigues of climate finance deliberations at the global stage. Although fronted as technical processes, these discussions frequently become marred with political dynamics that render the process unnecessarily convoluted and disadvantageous for certain nations, and especially the developing regions. The outcome is underrepresentation in decision-making and having agreed international outcomes that fail to mirror the distinctive financing challenges faced by EMDEs.
6. **Perceived and Real Foreign Currency Risk:** The risk associated with investing in many developing nations, Africa included, encompasses foreign currency (FX) fluctuations. The FX risk is often perceived as higher compared to investments in developed countries. This disparity in FX risk (or risk perception) is an added obstacle for mobilizing capital or securing funds at a favorable cost.
7. **Underutilized Private Sector Engagement:** The private sector's potential in climate finance remains largely untapped, with MDBs globally mobilising less than 30 cents of private capital for every public dollar spent on climate. Part of this challenge emanates from stringent commercial prerequisites set by private financiers and the complexity of accessing project preparation facilities. This further limits the participation of the private sector in financing climate transition in Africa.

In summary, these barriers vividly illustrate the multifaceted nature of challenges that impede climate transition financing in the region. The nuanced impact of each barrier underscores the necessity for focused interventions to clear the path for climate action financing. Moving forward, the next chapter will undertake a thorough exploration of bold and practical ideas and interventions designed to address these barriers, unlocking a transformative path towards a more resilient and sustainable future for the continent.

Breaking barriers: Five interventions to unlock climate financing

The implementation of bold interventions is pivotal in tackling financing barriers in Africa. This section will outline practicable strategies to break these barriers at a systemic level. They include offering below-market-rate or concessional capital to EMDEs, credit enhancement and guarantees to attract significant private capital, adept debt management for low- and middle-income countries, including innovative debt swaps and revised SDRs, and establishing a foreign exchange (FX) guarantee mechanism. Importantly, these initiatives hinge on robust collaboration and deep private sector engagement. Collectively, these interventions present a comprehensive strategy to finance climate transition in Africa, uplift vulnerable communities, and achieve localised sustainable development that is aligned with global climate goals.

There is a compelling pipeline of investable shovel-ready climate action projects in Africa. However, many of them often fall short of the stringent commercial prerequisites set by private financiers. This creates hurdles in originating projects and securing investments. A prominent reason is the inadequacy and complexity of accessing project preparation facilities, which is largely disjointed from subsequent access to funding and risk-reduction mechanisms. To counter this issue, it becomes imperative to cultivate an environment that can accelerate high-calibre projects while de-risking project funding.

Government entities play a crucial role in establishing the foundational framework to attract investments. Incorporating backing for these initiatives within national climate and developmental agendas can cultivate an environment conducive to private investors and bolster trust in government-driven investment priorities. Investor-facing events can effectively spotlight investment-ready projects in EMDEs, thereby capturing investor interest. Last year, the UN High-Level Champions facilitated regional finance forums that featured over 100 shovel-ready projects in EMDEs (UNHLC, 2022).

Debt relief and suspension for low- and middle-income countries, including innovative debt swaps and revised SDRs

We propose the reduction and suspension of debt for low- and middle-income countries. In line with our recommendation, we strongly endorse the following proposals of the Bridgetown Initiative:

For G20 Creditor Countries (either through the Common Framework for Debt Treatments or otherwise):

- Redesigning of the Common Framework for Debt Treatments to accelerate debt relief and cancellation, establish clear timelines, employ debt service standstills, and permit debt-distressed middle-income nations to access the framework.

For the IMF:

- Encouragement of consistent restructuring of unsustainable private debt through IMF programs, guided by locally driven fiscal sustainability plans.
- Refinement of Debt Sustainability Analysis, with adjustments to assign lower weight to debt resulting from future savings-generating investments.

For public, multilateral, and private creditors:

- Adoption of zero-cost, net-present-value neutral natural disaster clauses within lending instruments to enhance shock absorption.
- Refinancing high-interest and short-term debt with credit guarantees and extended maturities is recommended.

For UN Member States:

- Establishing new international resources (whether taxes, charges, or other sources) to fund the UNFCCC Loss and Damage Fund at a yearly level of $100 billion.

The more these countries are battered by the effects of climate change, the more they borrow to try to recover and the more their debt mounts. According to a recent IMF Working Paper, about 60 percent of low-income countries are in or near debt distress (Chuku et al., 2023). In addition, loan contracts should include debt-suspension clauses for natural disasters, and lenders should support debt-for-nature or -climate swaps in which recipients invest in nature regeneration and climate action in exchange for repayment. Further, de-risking project finance and extending concessional capital as earlier proposed will also help to alleviate debt by providing alternative finance options.

To assist climate-sensitive countries with debt management, innovative low-cost borrowing instruments with elongated maturities should be accessible via MDBs. This would endow countries with financial adaptability and the requisite duration for recovery from climate-induced adversities. Additionally, MDBs should adopt provisions pertaining to natural disasters in their fiscal instruments. Such measures would guarantee that unforeseen climatic events do not further aggravate debt situations. Also, promoting swift, equitable, and comprehensive debt relief discussions, inclusive of payment pauses and debt absolution, can offer invaluable fiscal relief to climate-sensitive nations.

It is also essential for creditors to endorse debt-for-nature or debt-for-climate exchanges. This can encourage eco-friendly investments in conservation, health, education, and other sectors that traditionally face financing challenges. Additionally, the establishment of rigorous mechanisms to scrutinize and oversee the influence of climate finance on SDGs is imperative, ensuring that funds are effectively channeled towards achieving these goals and comprehensive development.

Revising Special Drawing Rights (SDRs)

Championing the modification of SDR allocation to earmark additional capital for climate financing is also fundamental for debt management by LMICs. This proposed change will catalyze a larger portion for climate-specific projects on the continent. In line with this, we endorse the Bridgetown Initiative's suggestion to:

- Expedite the redirection of $100 billion of SDRs to the Poverty Reduction and Growth Facility (PRGT) and the Resilience and Sustainability Trust (RST)
- Allocate an additional $100 billion of paid-in capital contributions to MDBs and redirect SDRs to these institutions, starting with the AfDB by September 2023.

Streamlining the IMFs' RST prerequisites is crucial to amplify access to climate financing. Additionally, safeguarding the sustainability of the PRGT will be instrumental in reducing financing costs and enhancing its accessibility for climate initiatives. By adjusting SDRs and instituting these measures, we can breach the financial barriers facing climate transition in Africa, steering the continent towards more sustainable horizons.

Extending below-market-rate or concessional capital to EMDEs

We propose that MDBs, like the World Bank, provide poorer nations with a 1 percent interest rate, a 10-year grace period, and a 20-year repayment term for financing projects that boost resilience to climate change. This would enable local banks to lower interest rates for these initiatives.

Furthermore, governments and development agencies should establish substantial and adaptable pools of concessional capital, to support smooth and transparent financing for climate projects. To attract private sector investments in climate-aligned ventures, financial incentives and risk-distribution methods are crucial. These steps can ease the economic burden on African countries and encourage private sector involvement.

Exploring innovative avenues for grant financing, like international levies, can also inject funds in situations where traditional private revenue or public funding might fall short. By availing funds at sub-market rates, nations can secure essential capital for climate transitions without overburdening their economies.

Strengthening the lending capabilities of MDBs and conducting thorough assessments of callable capital by rating agencies are also vital. Boosting concessional resources and directing additional funds towards initiatives such as the Crisis Response Window Plus (CRW+) can bridge the funding gap for climate projects.

By delivering below-market-rate or concessional capital to African nations and other EMDEs, we can provide the necessary financial support to tackle climate challenges in these regions. These measures not only address the economic aftermath of climate change but also align with the sustainable development objectives outlined by the UNFCCC and countries' NDCs.

Credit enhancement and credit guarantee schemes to incentivise private sector participation

Implementing mechanisms such as credit enhancement and credit guarantees, which provide credit assurances, can effectively mitigate project financing risks, and encourage private investors. Extending credit guarantee schemes enhances investor confidence, driving private sector involvement through co-financing and risk-sharing. To achieve a just transition and amplify necessary investments, a significant increase in guarantees is crucial. The Bridgetown Initiative calls for public, multilateral, and private creditors to refinance high-interest, short-term debt with credit guarantees and longer maturities.

Prioritizing credit enhancement and credit guarantees helps navigate the financial intricacies of attracting private capital for climate financing in Africa. This necessitates coordinated efforts among governments, MDBs, and private investors. Although these credit assurances can potentially mobilize substantial private capital, they remain largely underutilized. Therefore, incorporating a structural element of credit enhancements and guarantees into pipeline development and project preparation facilities is essential. Designing and deploying catalytic capital and credit assurances demand a demand-driven and systemic holistic approach that addresses all aspects of project origination and financing.

Foreign exchange (FX) guarantee mechanism

We propose the establishment of a Multi-Partner Trust Fund (MPTF) designed to provide cost-effective currency and country hedges tailored for climate-related investments in Africa. This FX risk guarantee mechanism would help incentivize and facilitate the necessary magnitude of private investment. Access to this Fund would mean investors can mitigate currency risks and have enhanced currency-hedged returns. Consequently, this would significantly reduce the perceived risk associated with investing in EMDEs, even in the face of currency fluctuations.

For effective risk management of capital-intensive climate projects, establishing FX guarantee mechanisms is utterly vital. These structures are instrumental in navigating FX risks and fostering the use of cross-currency swaps and hedging instruments. Partnering with central banks is crucial in devising innovative FX guarantee schemes supportive of climate initiatives. By assuring a stable and advantageous currency exchange milieu, these strategies can entice foreign investment.

It's paramount to recognize that currency risk can overshadow macro-risk. On a global scale, currency risks are entrenched in international investments, especially in emerging markets with fluctuating exchange rates. The disparity in local currency ten-year bond yields epitomizes the enduring market currency risk. Therefore, addressing this dimension is vital when deliberating on FX guarantee mechanisms.

A turbocharger facility for climate action projects and entrepreneurs in Africa

Lastly, we propose the creation of a turbocharger facility for projects and entrepreneurs running project preparation programs on the continent.

Such a facility is especially important to accelerate existing projects and programs on the continent, especially those that can regenerate nature and help communities adapt to extreme weather events such as droughts, floods, and heatwaves. Currently, existing project preparation facilities are still too small, hard to access, and largely disconnected from follow-on funding and de-risking mechanisms. This facility does not need to be a brand-new fund with cumbersome infrastructure; it could be set up by existing funders and investment instruments already operating in Africa. States can support such projects in their climate and development plans, and the private sector can also add value by sharing early feedback and expertise with project developers.

Conclusion

Overcoming the financial barriers inherent in Africa's climate transitions requires a comprehensive strategy that effectively addresses various multifaceted challenges. These challenges encompass various factors including public finance limitations, market risk perception, FX risks, policy and regulatory hurdles, and the complexity of international climate finance mechanisms. However, within these challenges lie numerous opportunities to navigate impediments and drive the financing of climate action projects.

Leveraging below-market-rate or concessional funds, implementing adept debt management strategies for low- and middle-income countries, and integrating credit enhancement and credit guarantee techniques can be pivotal. Additionally, stimulating private sector engagement and introducing innovative mechanisms such as recalibrating SDRs, implementing debt-suspension clauses for natural disasters, employing innovative debt swaps, and establishing an FX guarantee mechanism can significantly strengthen the effectiveness of climate-centric initiatives. Lastly, a turbocharger facility could help accelerate projects that regenerate nature and help communities adapt to climate change impacts.

To break down the financing barriers and implement the proposals recommended in this paper, a collaborative approach and a multi-faceted strategy are essential. The five financial proposals outlined above can help African countries to mobilize substantial climate investments. The goal is to finance a just and equitable climate transition that spans across Africa; not one that is restricted to just a handful of countries deemed "investable". Achieving this transformative agenda requires collaboration at scale. This transformation therefore demands that various stakeholders, including governments, the private sector, multilateral institutions, and other international organizations, are steadfast partners.

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