

Innovative Climate Financing for a Just Transition in Africa



Seoni Han

Ph.D., Associate Research Fellow, Africa and Middle East Team
Korea Institute for International Economic Policy

Addressing climate change is a global challenge that demands innovative solutions and financing mechanisms to ensure a just transition in Africa. Despite its negligible share of global carbon emissions, Africa is paying disproportionately high price for impacts of climate change. The projected increase in temperature across Africa is higher than the global average. As a result, the region is experiencing greater variability in rainfall and temperature, as well as more frequent natural disasters. Africa is home to nine out of the ten countries most vulnerable to climate change.

African leaders stress the importance of “a just transition,” where global initiatives for green transition are carried out fairly, equitably, and to the mutual benefit of all, while respecting Africa’s development priorities. A ‘just transition’ refers to greening the economy in a way that is as fair and inclusive as possible to everyone concerned, creating decent work opportunities. As such, a just transition for Africa signifies investing with a clear goal of transitioning to a sustainable development while minimizing the

negative impacts of changes in the energy mix and economic structure of the region.

Fundamentally, a just transition in Africa needs to ensure sufficient, sustainable, and equitable energy for all. Although Africa has abundant endowment of energy resources, nearly 600 million people, or 43% of its total population, lack access to electricity.¹ With its population projected to comprise 25% of the global total, and its maximum electricity consumption growth of 95% by 2050, Africa requires significant investments to meet its growing energy demand and achieve universal energy access. Additionally, the transition must be conducted in a just manner that does not compromise the needs for regional industrialization, economic diversification, and decent job creation. Africa's economic growth is largely driven by fossil energy sources, which make up 50% of its exports. Nevertheless, to attain climate resilience, the continent faces the challenge of refraining from relying on fossil fuels for energy production and export, and transitioning to cleaner and renewable energy sources.

While promoting green growth is at the top of the agenda, building climate resilience in Africa comes at a high cost. African countries have committed themselves to ambitious targets for climate-resilient development, but the financing falls short of the requirements to achieve these goals. The Climate Policy Initiative estimates that African countries will need approximately \$250 billion annually between 2020 and 2030 to implement their Nationally Determined Contributions (NDCs). Yet, current investments are only about \$30 billion per year, leaving a significant climate financing gap in the region.

Considering the financial gap and the underdeveloped financial sector in Africa, mobilizing resources for investing in climate solutions requires innovation in financing structures. The global climate finance architecture offers a wide range of options ranging from commercial finance to highly concessional terms such as grants, loans, guarantees, and private equity. In Africa, the most prevalent form of climate finance is debt instruments, particularly loans. Between 2011 and 2019, about two-thirds of the climate finance in Africa was in the form of loans, often on non-concessional terms. Nevertheless, the growing dependence on loans to finance climate-related projects poses a risk to the debt sustainability of African economies. Hence, novel approaches should be devised to overcome the barriers of the financial market in the region.

Green bonds, among other capital market instruments, help to expand the financing pool available for climate-related projects by providing access to large-scale investors interested in stable and predictable returns. Green bonds can be issued by sovereign or corporate entities,

¹ IEA (2022), Africa Energy Outlook 2022.

and are particularly suitable for capital-intensive infrastructure projects for renewable energy systems or sustainable transportation networks. By dispersing ownership of debt across investors and offering diversified investment opportunities, green bonds reduce project-specific risks. Africa's green bond market is still in its early stage. In 2021, \$623 billion of green bonds were issued worldwide, but Africa accounted for only 0.26% of the global issuance for that year.² Egypt, Morocco, Kenya, Namibia, Nigeria, and Cote d'Ivoire are among the African countries that have issued green bonds.

For low-income, vulnerable, or highly indebted African countries, a possible solution is debt-for-climate swap. This involves trading external debt for climate actions, and can address both funding and the debt issues simultaneously. One of the most viable options for fulfilling climate obligations in Africa, this type of debt relief is carried out in local currency, reducing foreign exchange risk and the burden on future debt sustainability. Several African countries, including Ghana, Madagascar, Cameroon, and Seychelles, have already implemented bilateral or trilateral debt-for-climate swaps. With debt relief accounting for only 0.1% of debt instruments in Africa, there is considerable potential to increase the use of this method.³

Countries with insufficient fiscal capacity could benefit from the reallocation of Special Drawing Rights (SDRs).⁴ The International Monetary Fund (IMF) can increase the availability of climate funds for Africa by consulting with member countries to redistribute SDRs in favor of African countries. African countries should engage in bilateral negotiations with developed countries to secure the funds from this low-debt and flexible instrument, which addresses the large climate financing gap that stems from Africa's weak fiscal position and regulatory and governance obstacles.

In the global climate financing system, the private sector must take on a more prominent role by scaling up its investment to supplement limited public resources. However, the private sector faces challenges in making investments due to lack of understanding of the risks and vulnerabilities related to climate change, as well as the benefits of investing in climate sectors. Currently, private sector participation in climate finance flowing into Africa is significantly low, standing at 13% as of 2019-2020, compared to the average of 42% for other developing countries.

² Climate Policy Initiative (2022), Climate Finance Innovation for Africa.

³ AfDB (2022), African Economic Outlook 2022.

⁴ Special Drawing Rights (SDRs) are supplementary reserve assets that the International Monetary Fund (IMF) allocates to its member countries to boost global liquidity. The allocation of SDRs is unconditional and based on economic size, so poorer countries receive less than richer countries.

Blended finance is an innovative approach that uses non-tradable financial instrument to address this problem. Public investors can use blended finance as a catalyst to attract private investments in areas where projects require high initial costs, long-term investments, and are associated with various risks. Public funds can be combined with private funds to manage risks and returns for private investors. Grants, or concessional loans can be provided to fund early-stage non-commercial activities which are critical for new projects to become financially viable.

Natural capital accounting is an emerging area related to climate financing that is increasingly being used in decision-making processes. Africa, which is rich in natural resources including 30% of the world's mineral resources and 65% of its arable land, can leverage this natural capital to finance a transition to a greener economy. However, Africa's natural capital is at risk due to global warming, loss of biodiversity, land degradation, exports of raw materials, and other forms of mismanagement. Therefore, it is essential to ensure that the natural resources in Africa are managed sustainably and that important ecosystem services are well maintained. Valuating the economic worth of natural assets and ecosystems enables countries and businesses to comprehend the environmental impacts of their activities, mitigate supply chain risks, and make informed decisions about managing their natural capital.

Although Africa is highly susceptible to the effects of climate change and has low preparedness to adapt to climatic shocks, it holds enormous potential. The rapidly expanding African population and abundant renewable energy and mineral resources make sustainable development essential for the continent's interests. Tackling climate change provides opportunities to create future drivers of economic growth. Therefore, it is crucial for the international community to strongly support African countries' efforts in this regard by introducing innovative financing schemes to improve resource allocation efficiency, and strategically deploy public funds to attract private investments. Guidelines for responsible investments are necessary to ensure a just transition for Africa, reconciling the continent's development needs and climate obligations. **KIEP**