development initiatives

Beyond carbon markets: financing development

Meeting on ‘Regulating carbon markets: building capacity for the Implementation of Article 6 of the Paris Agreement’, 14 to 16 May 2024, Rainbow Hotel, Victoria Falls

Background

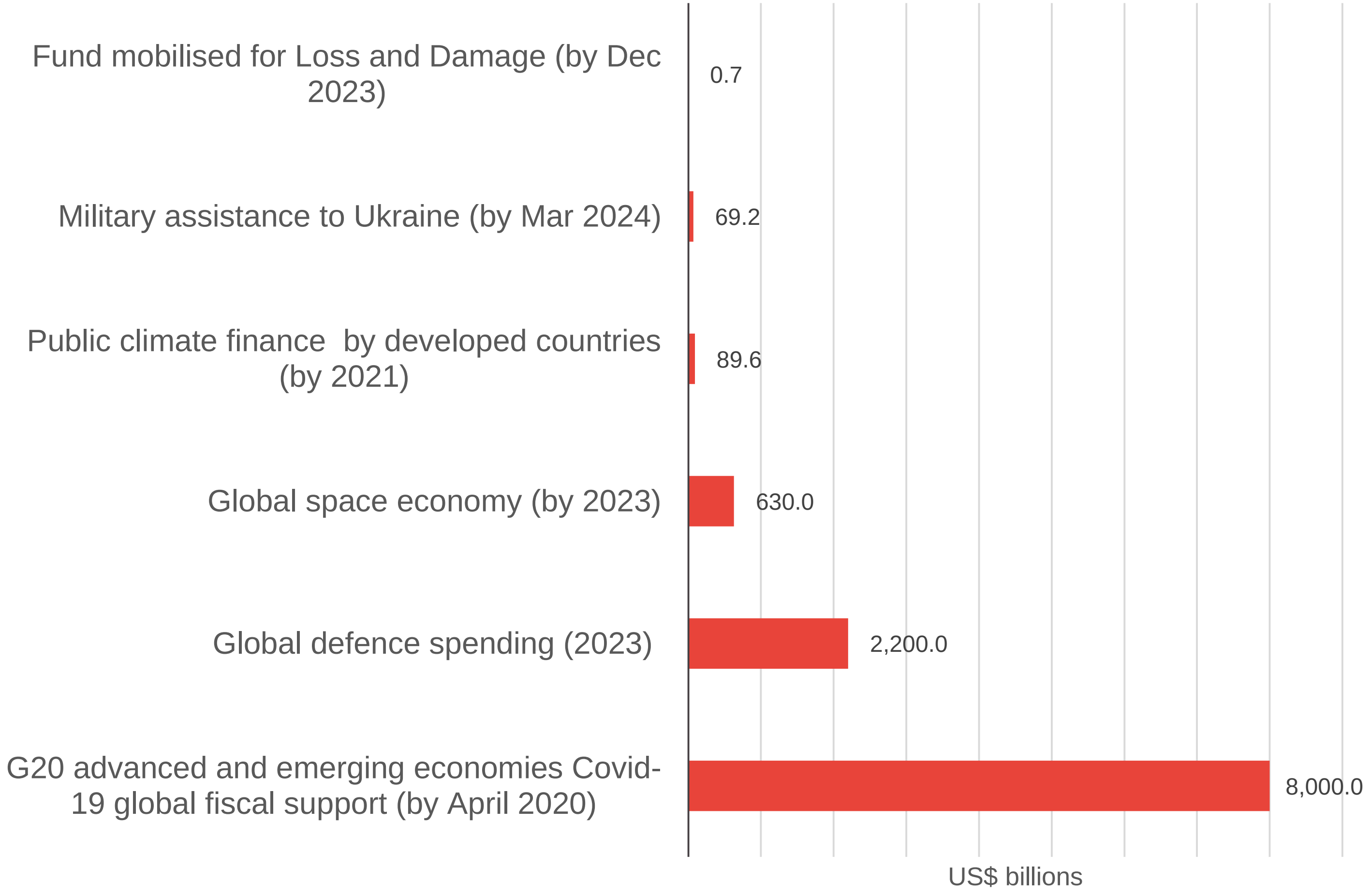
- Yesterday, we heard
  - The primary objective of Article 6 is for mitigation, not as a source of finances.
  - Presentations showed the administrative and institutional burden of implementing Article 6.
  - Countries must have a vibrant economy to benefit from carbon markets.
  - We also heard the Clean Development Mechanism delivered only 3% of all CDM projects in Africa since 2005 (though it could be as high as 33% since 2016).

Outline of the presentation

- The framing
    - Financing gap – SDGs and climate action
    - Debt – examples from WB and China
    - Credit rating
- Strategic steps − fresh, additional, better money

1. Large climate financing gap

Climate financing compared with other funds raised



Developing countries require between US$194 billion and US$366 billion per year to adapt to climate change.

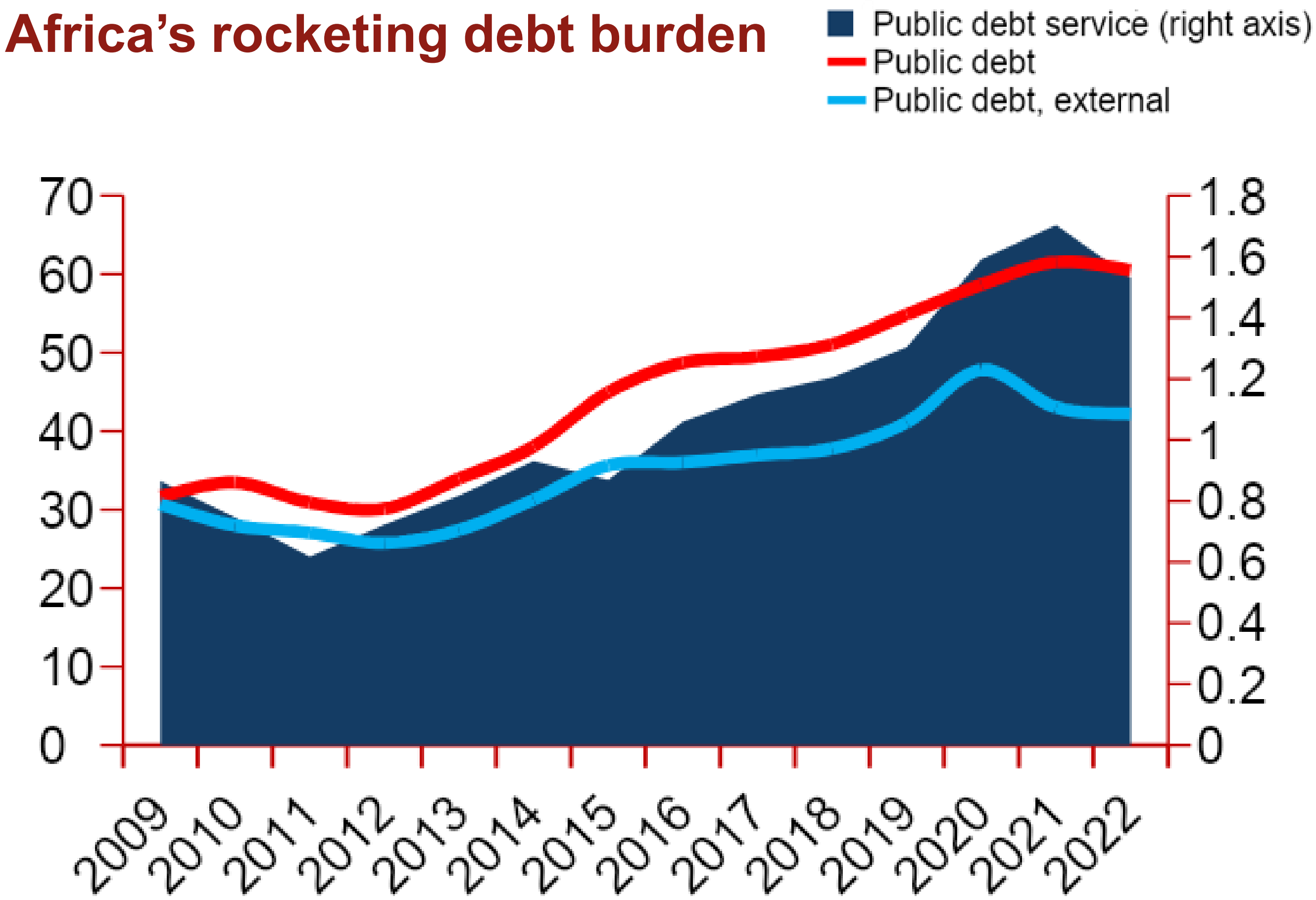
That is **10−18 times more** than what current international public adaptation finances provide.

2. Large SDG financing gap

- Africa needs **US$194 billion** annually to meet the SDGs.
- SDGs that are crucial for **structural transformation** are performing dismally:
  - SDG 7 (affordable and clean energy) and SDG 9 (industry, innovation and infrastructure) have the lowest scoring.
  - SDG 8 (decent work and economic growth) performance deteriorating over the years.

3. Debt, debt and more debt in Africa

Africa's rocketing debt burden



External debt growth has outpaced the growth of the economy/GNI by 72 percentage points in sub-Saharan Africa. In North Africa, Egypt's debt accumulation rose by 307% and its GNI rose by 69%.

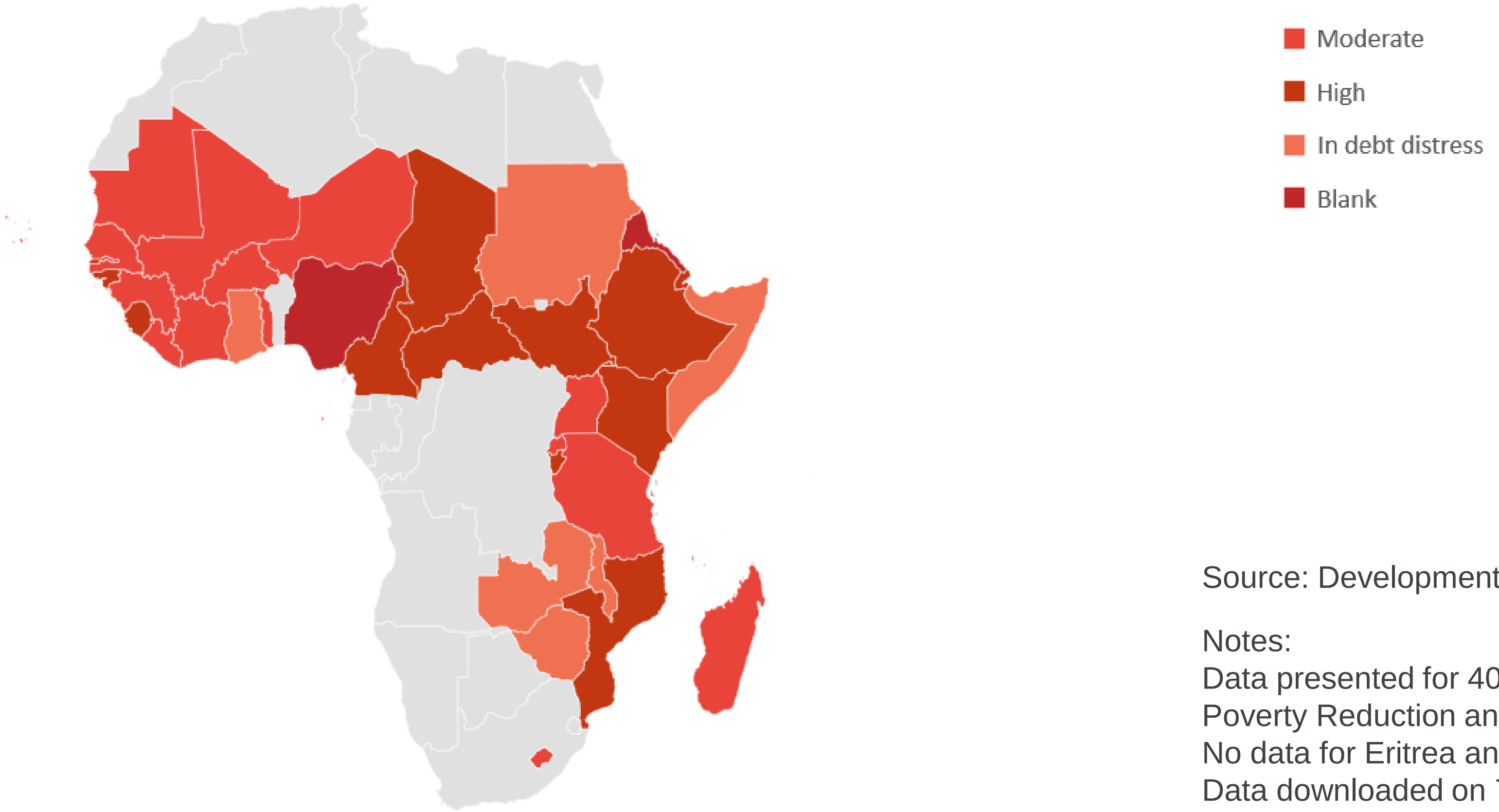
Debt service is absorbing 54% of revenue and 40% spending in Africa.

The **public debt burden** of African countries reached US$1.8 trillion in 2022. Sub-Saharan Africa alone owed US$1.14 trillion at the end of 2022.

Source: IMF Oct. 2023 WEO, WB Feb 2024 WDI, and author's computation

Debt stress: Constrained fiscal policy space

8 African countries in debt distress, 13 at high risk of debt distress



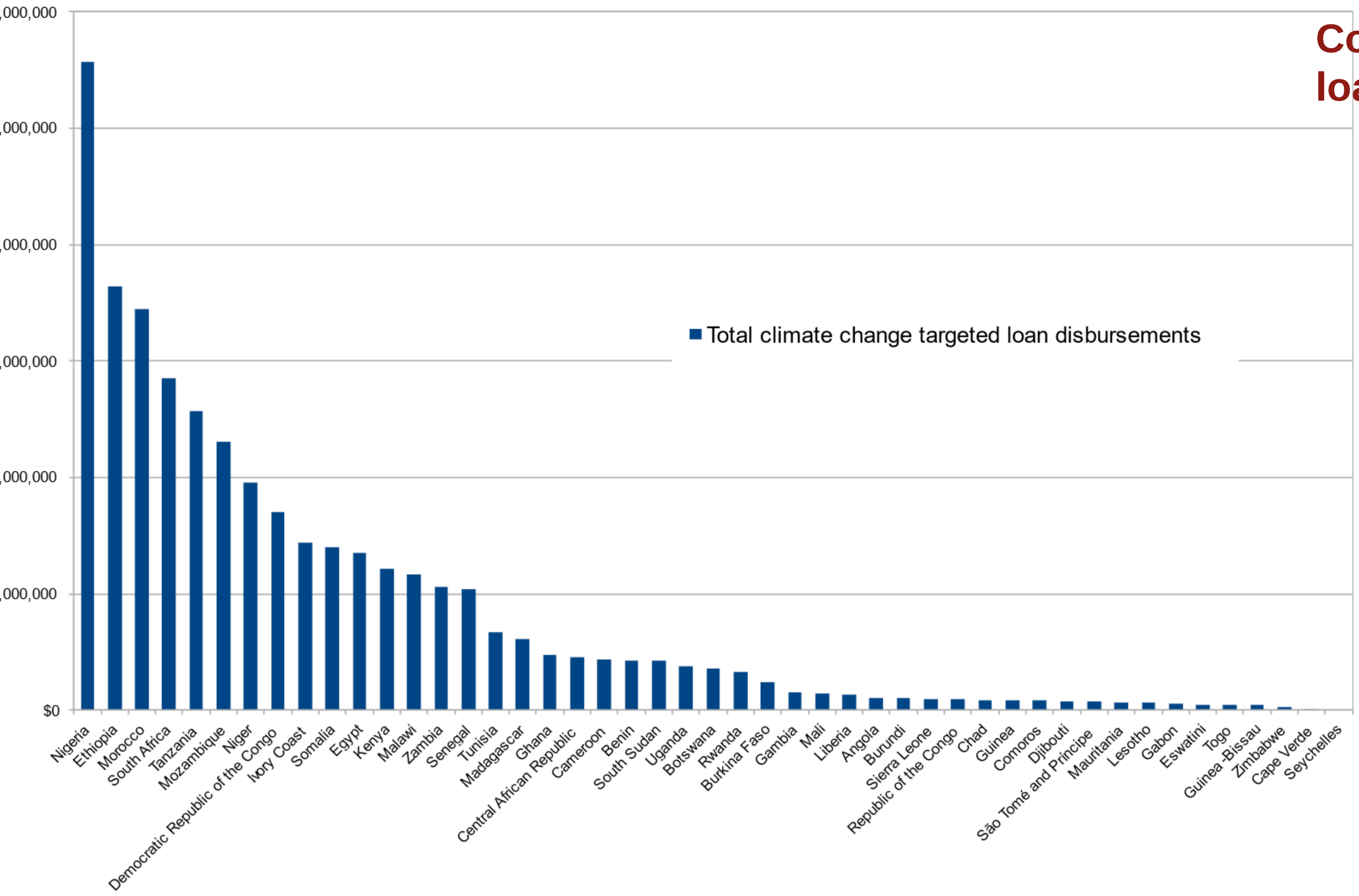
Source: Development Initiatives based on IMF data

Notes:
Data presented for 40 sub-Saharan African countries that are Poverty Reduction and Growth Trust (PRGT) eligible.
No data for Eritrea and Nigeria.
Data downloaded on 7 March 2024

Loans for climate action

- The climate finance landscape is dominated by **loans**.
- Multilateral DFIs, the primary source of international public climate finance, channelled:
  - Nearly half (47%) of loans at **market rate,**
  - Slightly less than one-third (30%) at a **concessional rate** – mainly in the energy sector – and
  - Less than a quarter (20%) as **grants**.

Borrowing from the WB for climate action



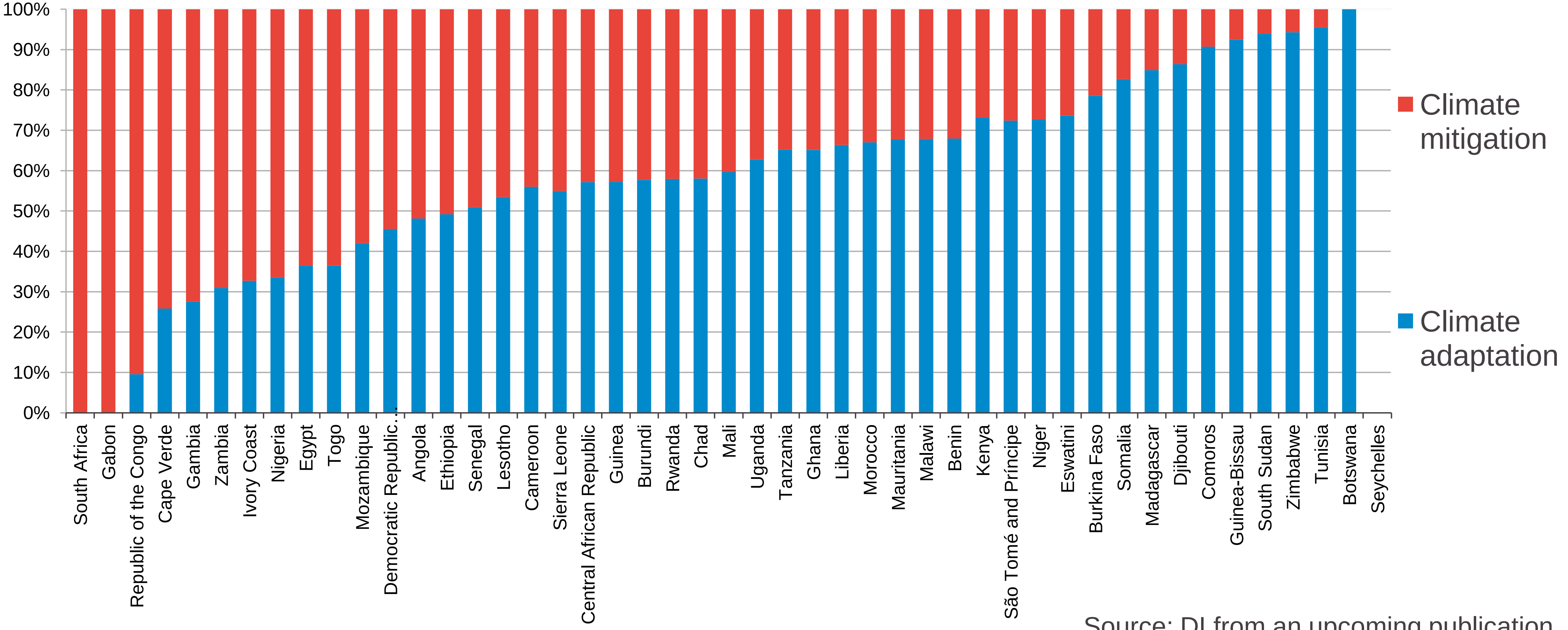
Concentration of borrowers: 69% of total loans to Africa in 2022 went to 10 countries

Recipient name	Share of total loans to Africa
Nigeria	14%
Ethiopia	9%
Morocco	9%
South Africa	7%
Tanzania	7%
Mozambique	6%
Niger	5%
Democratic Republic of the Congo	4%
Ivory Coast	4%
Somalia	4%

Source: IATI

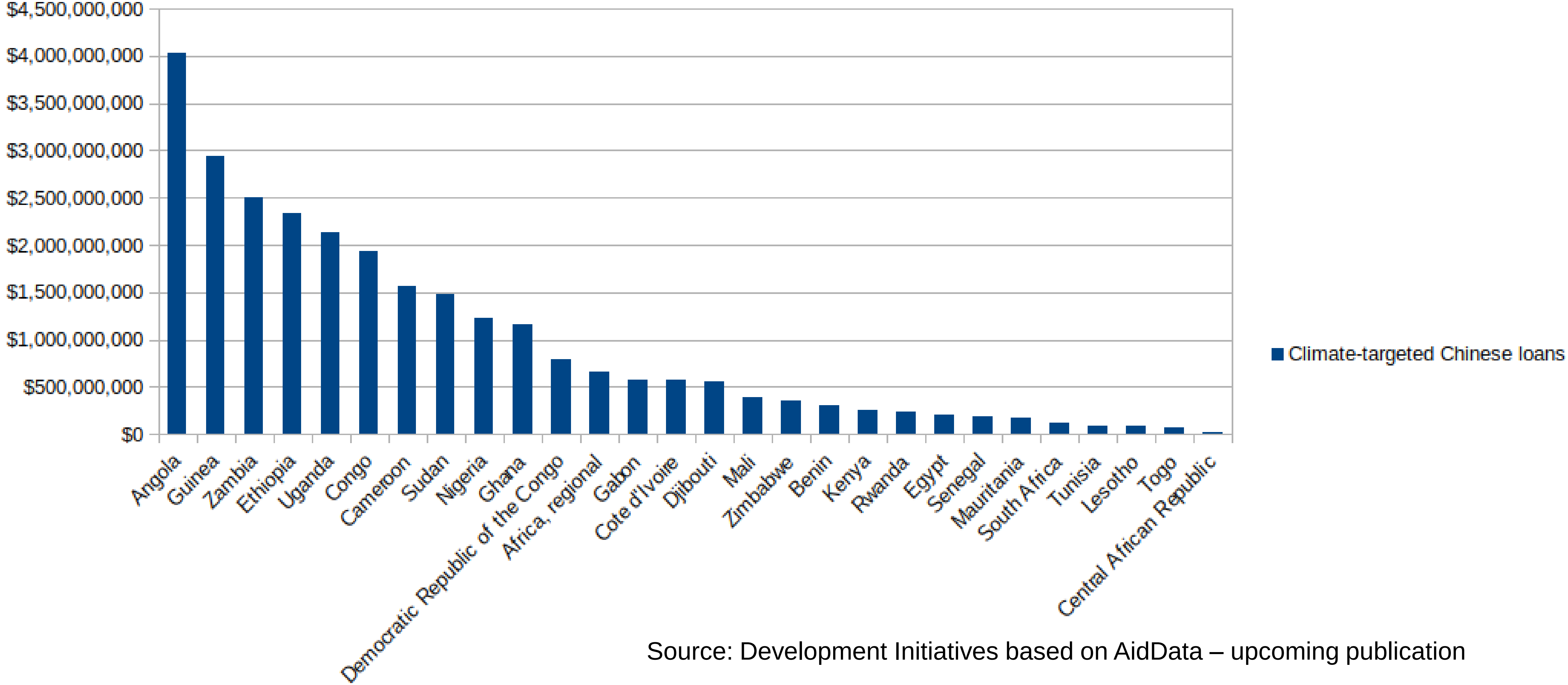
Proportion of World Bank loans for CM (orange) compared to CA (blue)

A high concentration of one or the other action



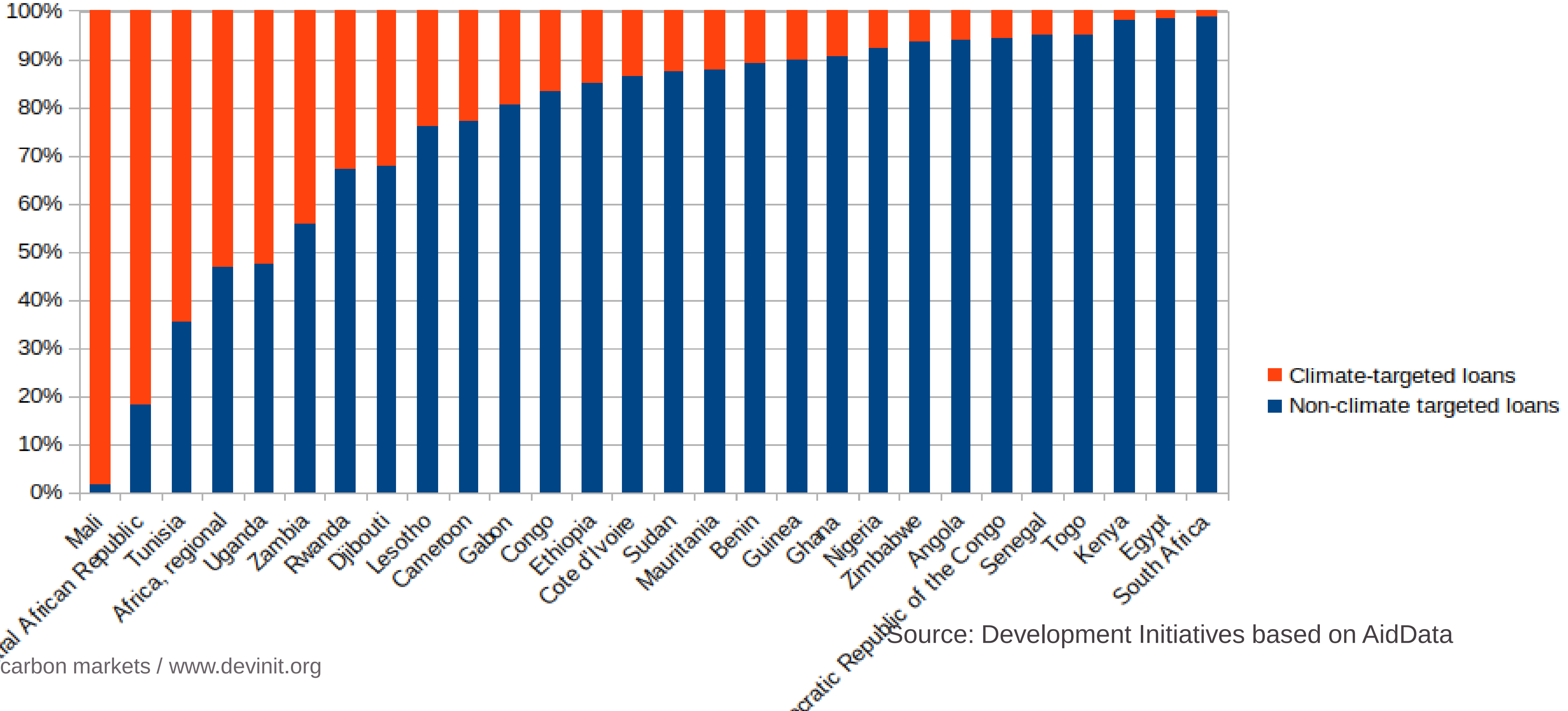
Source: DI from an upcoming publication

Chinese loans to AU countries for climate-finance projects that were active in 2022



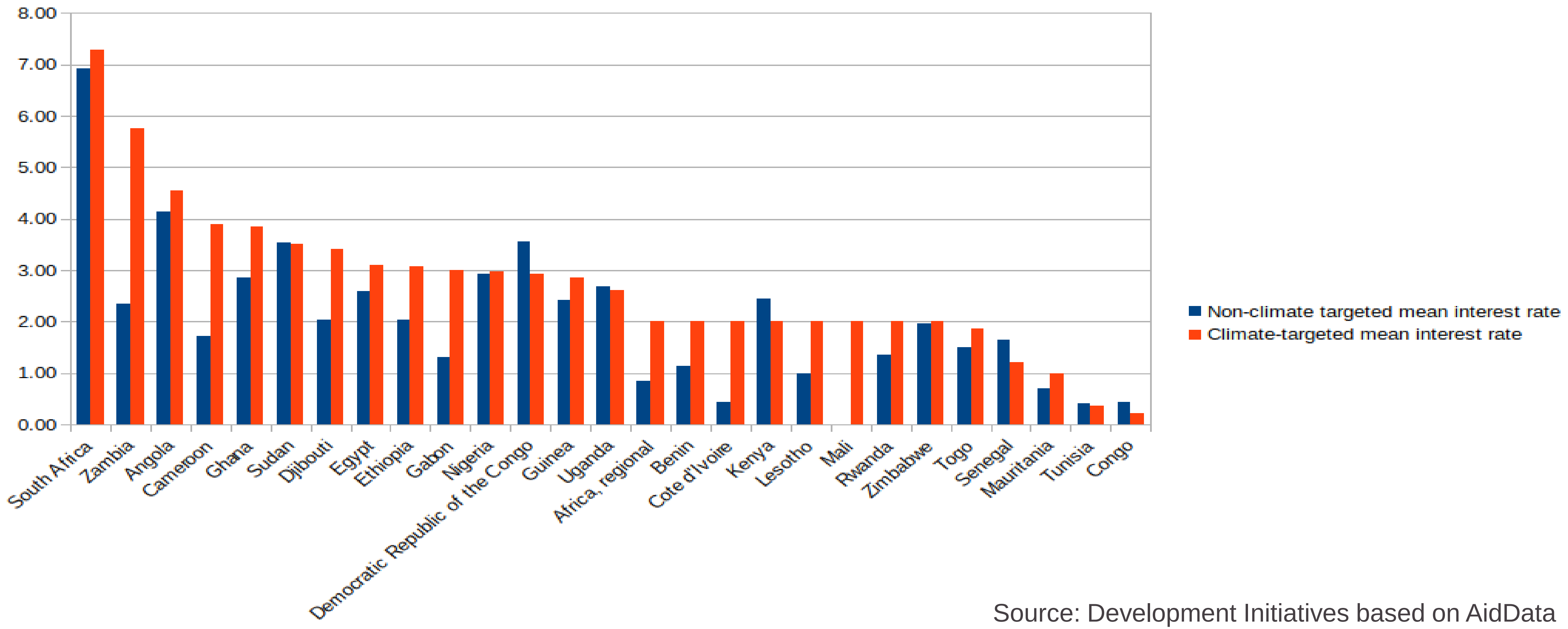
Source: Development Initiatives based on AidData – upcoming publication

Proportion of Chinese loans for climate action (orange) compared to non-climate action (blue)



Source: Development Initiatives based on AidData

Average interest rates of climate-targeted loans (orange) compared with non-climate-targeted loans (blue)



Source: Development Initiatives based on AidData

4. Poor credit rating

Credit unworthiness of Africa – risk perception of Africa

- We face what Mo Ibrahim calls ‘mafia type’ interest rate − **high borrowing costs** (terms and rates). LDCs face interest rates up to **eight-times higher** than developed countries. For example, loans to enable solar farms in Europe attract a 4% interest rate compared to 10% in South Africa.

- ‘**Borrowing from capital markets** is costing African governments **500%** what it could if G20 leaders delivered swiftly on **financial reform**.’

- Unfavourable behavioral and institutional attitude towards Africa.

- The current LIC-DSF has unconvincing projections to determine the creditworthiness of African countries by using the simplistic approach of categorising countries as ‘low', 'moderate', high-risk' or 'in distress’.

- The UNECA has already declared that the Environmental, Social and Governance (ESG) rating criteria are subjective, inconsistent, lack transparency and standardised measurement in methodologies.

Strategic next steps for Africa

Domestic resources

Double down on domestic resource allocation for climate adaptation

- Government expenditure for adaptation in Africa is greater than private adaptation spending, and 10 times larger than international support for adaptation.

- Whatever the true scale of need, various estimates suggest that a significant proportion of the required funds come from domestic resources. For instance, of the US$2 trillion additional finance required by 2030 to fully implement the Paris Agreement and cap temperatures, it is estimated that 40% could come from domestic resources.

- The domestic sources could include domestic capital markets, stronger tax collection and reduced fossil-fuel-associated subsidies and other sources of tax revenue such as value added, income and property tax.

On the table, but whose table?

Strengthen agency for a fair global economic governance

- An unfair global cooperation architecture. Options:
  - Complete overhaul of the current system − unrealistic due to its complexity and entrenchment?
  - Reform(s) of the current system – what is the incentive beyond merely cosmetic changes?
  - Active engagement in strengthening an alternative system for a new global governance structure for checks and balances – already happening … [BRICS, G21, ‘the Africa Club’]

Reducing borrowing costs

- Reforming the current LIC-DSF would require, at a minimum, calculating credible projections to determine the creditworthiness of African countries beyond the simplistic approach of categorising countries as ‘low’, ‘moderate’, ‘high-risk’ or ‘in-distress’.
- E.g., a 0−100 score or index without falling into the trap of biased judgement a country’s creditworthiness, which is much more complicated.

The role of AfDB and ADF-17

- AfDB is holding its 59th annual meeting end of this month at a historic juncture
- AfDB needs to secure a seat and guide the global discussions agenda, such as the G7. This should be on the global financial architecture for revisions of the financing instruments, programmes and knowledge products across the multilateral development banks and the IMF (which inform private creditors' and rating agencies' decisions about Africa's creditworthiness).
- AfDB needs to produce influential knowledge products and inform global policy discussion to increase resource allocations to climate financing.
- We need more contributors for the 17th Africa Development Fund replenishment cycle. Already the number of African countries contributing to the fund is **steadily increasing**. There is need for more ownership and pledges to the 2025 replenishment cycle, despite the 2024−2025 replenishment traffic jam.

Challenge-led funding

The role of publicly funded investment banks

- Strengthen publicly funded/state investment banks.
- Mission-oriented or challenge-led financing is better positioned to tackle the climate challenge than private capital, which tends to be short-termist and risk-averse.
- Such finances promote countercyclical finance during economic recessions and are willing to fund long-term projects, high-risk research and development, and innovations addressing complex societal problems such as climate change.

Historical emissions and carbon sequestration

- Are we locking ourselves into agreements that undermine long-run prosperity and flexibility in the emissions space?
- Quantify the contribution of carbon sinks in conservation efforts and climate financing.

  E.g., as President Mohamed Irfaan Ali of Guyana reiterated, his country's extensive forest cover, spanning 18 million hectares, stores approximately 19.5 gigatonnes of CO^2. Meaning whatever exploration Guyana carries out, it would still be able to more than offset through its carbon sink.

In summary

More questions

- **Reform, overhaul or alternative system**: Will it go beyond cosmetic changes – addressing power imbalances? Will it enhance Africa’s agency?

- **Is Africa (the AfCFTA Sec) preparing for a retaliation to the Carbon Border Adjustment Mechanism?** Are there opportunities not just to snap out of the ‘learning phase’ but to be proactive in setting the agenda?

- **Carbon markets**: Are we seeking market solutions that are based on capitalism and neoliberalism, the very reasons we are here?

Thank you!

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