Africa Business Forum 2023

Making Carbon Markets Work for Africa

Regional integration driven by the Agreement Establishing the African Continental Free Trade Area

Strengthening the integrity of the carbon market and facilitating intra-African trade in carbon credits

United Nations
Economic Commission for Africa

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Background document

Once it is fully implemented, the free trade area created by the Agreement Establishing the African Continental Free Trade Area will be, by the number of members, the world's largest free trade area, making its scope large, its ambition high, and its potential enormous. The size of the Area alone promises to drive development across the continent, but the true power of the Agreement lies in its ability to unite the continent's largely disparate and fractured economies, building an integrated platform that is resilient, sustainable and inclusive.

Modelling by the Economic Commission for Africa (ECA) predicts that the Agreement will increase African gross domestic product, trade, output and welfare. Not surprisingly, however, the largest gains are expected to come through increased intra-African trade. In fact, with the Agreement in place, this trade is expected to grow by nearly 35 per cent by the year 2045, as compared with the situation which would prevail without the Agreement. Intra-African trade in each of the major sectors of agrifood, industry and services is expected to grow by approximately 49 per cent, 36 per cent and 38 per cent, respectively; It is crucial to note, however, that the energy and mining sectors, while still expected to grow, will grow by only around 19 per cent.[1]

The relatively less impressive growth in Africa's energy and mining sector is encouraging from the point of view of the three-way relationship between trade, emissions and climate change. From this perspective, increased trade, as expected to occur under the Agreement, will drive production processes and increase transport, which will ultimately increase emissions and contribute to climate change. Simultaneously, climate change can disrupt trade and production processes that may affect the livelihoods of millions. However, increased trade under the Agreement need not necessarily be detrimental to the environment. Through its ability to bring economies together and drive regional integration, the Agreement can serve as a vehicle to reduce emissions and increase the availability and affordability of environmentally friendly goods, services and technology. Besides reducing costs, the Agreement is expected to contribute to the harmonization of regulatory policies that have the potential to create a level playing field when it comes to green opportunities, to help create a common continental framework for trade and investment in green goods and services, and to lay the foundation for a common African carbon market.

ECA is currently assisting member States in integrating green considerations in their economic frameworks by, among other measures, providing technical assistance in the development of national implementation strategies for the Agreement, supplemented by additional research on the development of green value chains. In addition, ECA, through the African Trade Policy Centre, and, in collaboration with the Centre for International Research and Economic Modelling, is conducting an analysis to assess the implications of the Agreement for climate change, as well as the opportunities and challenges involved in creating a single African carbon market. Voluntary carbon markets can play an important role in accelerating the economic development of Africa while also curbing greenhouse gas emissions.

Following the twenty-seventh session of the Conference of the Parties to the United Nations Framework Convention on Climate Change, held in Sharm el-Sheikh, Egypt, in November 2022, the Global Energy Alliance for People and Planet, Sustainable Energy for All and ECA, with support from the United Nations high-level champions for climate action,

[1] For an assessment of the economic impact of the Agreement, see: https://hdl.handle.net/10855/46750.

launched the Africa Carbon Markets Initiative to drive the production of African carbon credits while ensuring that carbon credit revenues are transparent and equitable and create jobs.

To further study the market for carbon credits, ECA and the Centre for International Research and Economic Modelling are conducting research to gauge the impact of a common African carbon price. The aim of this research is to determine which countries may be able to meet their nationally determined contributions at a set African carbon price. The results of this analysis will also help to identify priority sectors at the national level to consider when issuing carbon market credits.

Carbon markets: questions and answers

1. **What are carbon markets?**

In 2015, 196 States voted in favour of the Paris Agreement at the twenty-first session of the Conference of the Parties to the United Nations Framework Convention on Climate Change. The Paris Agreement entered into force on 4 November 2016. Its main goal is to limit global warming to well below 2°C, and preferably to 1.5°C, compared with pre-industrial levels. To achieve this target, global greenhouse gas emissions must peak as soon as possible. Article 6 of the Paris Agreement recognizes the possibility of international cooperation through the transfer of mitigation outcomes, essentially leading to the establishment of carbon markets. Carbon markets are important tools for reaching global climate goals, as they incentivize climate action by enabling parties to trade carbon credits generated by the reduction or removal of greenhouse gases from the atmosphere.

2. **What types of carbon markets are there?**

There are two types of carbon markets: compliance markets and voluntary markets. Compliance markets are used by companies and Governments that, by law, have to account for their global greenhouse gas emissions. In voluntary markets, private actors voluntarily buy and sell carbon credits that represent certified removals or reductions of global greenhouse gases from the atmosphere.

3. **Why are voluntary carbon markets important for Africa?**

Global companies are increasingly investing in carbon markets as part of their efforts to reach net-zero carbon emissions. Voluntary carbon markets grew at a compound annual rate of over 30 per cent between 2016 and 2021[2] (based on carbon credit retirements), and demand for African carbon credits grew at a compound annual rate of 36 per cent in the same period.[3] Voluntary carbon markets enable cross-border financing to move from developed to developing countries. An African carbon market must gain traction to attract finance to African countries, by creating a meaningful asset for the continent that supports developmental priorities while preserving the continent’s natural endowments.

4. **What is the state of voluntary carbon markets in Africa?**

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[2] Africa Carbon Markets Initiative (2022). *Africa Carbon Markets Initiative (ACMI): Roadmap Report* (Vienna, Sustainable Energy for All, 2022). Available at: www.seforall.org/publications/africa-carbon-markets-initiative-roadmap-report.

[3] Ibid.

Over the past five years, five countries (Democratic Republic of the Congo, Ethiopia, Kenya, Uganda and Zimbabwe) have accounted for over 65 per cent of total carbon credits issued on the continent.[4] However, many African countries have a high potential to issue carbon credits. Moreover, the vast majority of current projects have been of similar types, with around 97 per cent of carbon credits being issued in forestry and land use, renewable energy and household devices.

5. What are the main challenges to the growth of African carbon markets?

African carbon markets face several challenges on both the supply and demand sides of the market. On the supply side, projects are currently relatively small in scale and show limited diversification. Moreover, significant up-front capital is needed to start a carbon credit project, and it must demonstrate a relevant business case for investors. Regulatory uncertainty and complexity also add to the concerns of carbon credit developers, as well as create a difficult environment for doing business, since many African landowners do not have formal title to their land, or the land is situated in areas of conflict. Finally, validation and verification of carbon credits can be costly and take a long time. On the demand side, globally, there are concerns regarding the integrity of carbon credits, because emission reductions are difficult to confirm. Furthermore, pricing of carbon credits is not always transparent and may not reflect the benefits to the environment. Finally, except for South Africa, there is no local demand on the continent for carbon credits, with African countries relying on international demand.

6. How can the Agreement contribute to the establishment of a continental carbon credit market?

The Agreement will help to integrate the continent’s small and fragmented economies and harmonize the regulatory environment. Policy harmonization will cause confidence and transparency in African markets to grow, helping to attract foreign investment. Moreover, the conclusion of negotiations surrounding a protocol to the Agreement on investment will give investors additional legal protection and information on existing continental market risks. All of these factors can contribute to the establishment of a continental carbon credit market.

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[4] Ibid.

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